
AUDIT REPORT



CITY OF SPRINGFIELD
SELECTED ACTIVITIES FUNDED THROUGH THE COMMUNITY
DEVELOPMENT BLOCK GRANT, THE HOME GRANT AND THE
URBAN DEVELOPMENT ACTION GRANT PROGRAMS
SPRINGFIELD, MASSACHUSETTS

2004-BO-1003
November 7, 2003

*OFFICE OF AUDIT, NEW ENGLAND
BOSTON, MASSACHUSETTS*



Issue Date	October xx, 2003
Audit Case Number	2004-BO-XXXX

TO: Robert Paquin, Director, Office of Community Planning and Development, 1AD

FROM: Barry L. Savill, Regional Inspector General, Office of Audit, 1AGA

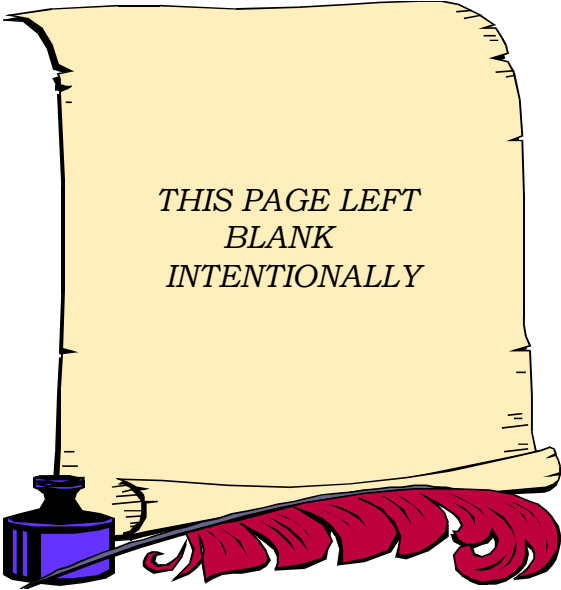
SUBJECT: City of Springfield, Massachusetts
Selected Activities funded through the Community Development Block Grant,
HOME Grant, and Urban Development Action Grant Springfield, Massachusetts

We completed a review of 33 loans totaling \$691,803 in HUD funds awarded by the City of Springfield (City). These loans were funded through three HUD programs: Community Development Block Grants, HOME Grants, and miscellaneous income generated by Urban Development Action Grants. Our primary objective was to determine whether certain loans were awarded in accordance with the City's policies, the City's procedures and applicable HUD regulations.

Our report contains three findings requiring action by your office. The three findings address: 1) Mismanagement in the City's Business Improvement Program; 2) Community Development Loans Did Not Meet Program Requirements; and 3) HOME Program Requirements Not Met.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us a status report for each recommendation without a management decision on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Cristine M. O'Rourke, Assistant Regional Inspector General for Audit or me at (617) 994-8380.



Executive Summary

We reviewed 33 loans awarded by the City of Springfield (City) that were funded through Community Development Block Grants, HOME grants, and miscellaneous income generated by Urban Development Action Grants during the period January 1, 1996 through March 31, 2001. The 33 loans totaled \$691,803. Our review was initiated as a result of several newspaper articles, which reported allegations that the Springfield, MA Office of Community Development was misusing Federal funds. Our primary objective was to determine whether certain loans were awarded in accordance with the City's policies, the City's procedures, and applicable HUD regulations. Our review was limited in nature and focused on specific loans within the City's community development programs. The issues identified in our report deal with administrative and internal control activities that we feel are necessary to bring to the City's attention now, even though many issues surrounding the City's management actions remain a continuing interest to our office as well as other Federal agencies. This report does not absolve or exonerate any individual or entity from civil, criminal or administrative liability or claim resulting from future actions by the Department of Housing and Urban Development and other Federal agencies.

Audit Results

Our audit disclosed problems with the City's management of Community Development Block Grants (CDBG), HOME funds, and miscellaneous income generated by the Urban Development Action Grants (UDAG). The City did not always comply with its own policies and procedures, follow HUD program requirements, or maintain essential documentation. In addition, the City lacked effective internal controls in some areas. Of the \$691,803 in costs reviewed, we questioned \$674,194.

Questioned Costs of \$187,699 in Business Improvement Program

The City mismanaged its Business Improvement Program (BIP). We reviewed 28 BIP projects involving \$205,308 and found \$159,794 expended for ineligible projects and \$27,905 expended without sufficient documentation. Additionally, the City had inconsistencies in the processing of loan applications and requests for payments that had the appearance of favoritism.

Ineligible Community Development Loans of \$360,000

Our review of three Community Development loans, totaling \$360,000, disclosed that the City's files lacked documentation to determine that all the loans met program requirements and national objectives. The loan files did not contain basic documentation such as applications, award determinations, commitment letters, and demonstration of the achievement of national objectives. Because of the nature and extent of the deficiencies, the \$360,000 is ineligible. Two of the Community Development loans were provided to individuals/entities who also benefited

HOME Expenditures of \$126,495 do not Meet Requirements

under the BIP. The third loan was provided to a non-profit entity managed by City employees.

Our review of two HOME-funded projects, totaling \$126,495, disclosed program deficiencies. We found:

- 1) Affordability requirements were not met,
- 2) The assistance may have unduly enriched the project owner;
- 3) Disbursements were made for ineligible costs and contrary to Federal program policy; and
- 4) Several unexplained deviations from City program policies governing disbursements.

Neither of the HOME funded projects was completed in accordance with the original scope of rehabilitation work. As a result of the deficiencies disclosed, we consider the \$126,495 in costs ineligible.

City's Actions Compromise Program Integrity

In addition to the questioned costs, program integrity is potentially compromised. Grant and program funds provided by the Federal government are required to be spent in such a way that represents "best use" of the funds and provides maximum benefit to the intended beneficiaries. Public support for programs such as CDBG and HOME is based, in part, upon the requirements of the Office of Management and Budget (OMB) Circular A-87 Cost Principles for State, Local, and Indian Tribal Governments, which requires funds to be spent in a prudent manner as a reasonably responsible person would spend them.

Recommendations

We recommend that you:

1. Review the questioned costs and determine whether the costs are ineligible under the respective HUD program.
2. Require the City to reimburse HUD from non-Federal sources for any costs deemed ineligible.
3. Require City officials to implement adequate internal controls to ensure that City policies and procedures are followed, and HUD program requirements are met.

Findings and
Recommendations
Discussed

A draft discussion report was provided to the City on July 16, 2003. We discussed the findings with the City during an exit conference on July 31, 2003, and a subsequent meeting held August 20, 2003. At our request, the City provided comments on each of the findings. We received the City's narrative response and exhibits on September 29, 2003. The City's narrative response and its list of exhibits are included in Appendix D. The City's exhibits were too voluminous to include in our report.



Table of Contents

Management Memorandum	i
-----------------------	---

Executive Summary	iii
-------------------	-----

Introduction	1
--------------	---

Findings

1. Mismanagement in the City's Business Improvement Program	5
2. Community Development Loans did not Meet Program Requirements	21
3. HOME Program Requirements Not Met	31

Management Controls	39
---------------------	----

Follow Up on Prior Audits	41
---------------------------	----

Appendices

A. Schedule of Ineligible Costs and Questioned Costs	43
B. Loans Reviewed	45
C. Business Improvement Program Loans	47
D. Auditee Comments	49

Abbreviations

BIP	Business Improvement Program
CDBG	Community Development Block Grant
City	City of Springfield, Massachusetts
HOME	The HOME program
HUD	U.S. Department of Housing and Urban Development
OMB	The Office of Management and Budget
UDAG	Urban Development Action Grant

Introduction

We initiated this review in response to several newspaper articles published in local newspapers, beginning in late 2000, which reported allegations that the Springfield, Massachusetts Office of Community Development was misusing Federal funds.

Community Development Block Grant Program

Title I of the Housing and Community Development Act of 1974 established the Community Development Block Grant Program (CDBG). This program provides grants to States and local governments to aid in development of viable urban communities. Governments are required to use grant funds to provide decent housing and suitable living environments and to expand economic opportunities for persons of low and moderate income. All program projects and activities must meet one of the three national objectives of the CDBG program:

- (1) Directly benefit low and moderate income persons,
- (2) Aid in the elimination or prevention of slums and blight, or
- (3) Meet other community needs that have a particular urgency.

Federal regulations provide that, to be allowable, costs must meet certain general criteria, including that the cost is consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit. Annual CDBG allocations to the City of Springfield for Federal fiscal years 1996 to 2001 totaled \$30,967,000 as follows:

<i>Fiscal Year</i>	<i>CDBG Funds</i>
2001	\$5,272,000
2000	5,082,000
1999	5,063,000
1998	5,032,000
1997	5,241,000
1996	5,277,000
Total	\$30,967,000

Urban Development Action Grant Program

Section 119 of the Housing and Community Development Act of 1974 established the Urban Development Action Grant Program (UDAG). This program was created to assist cities and urban counties experiencing severe economic stress. Grants were made to local governments who used the funds to make loans to private developers for commercial, residential, or industrial projects in order to stimulate economic development necessary for local economic recovery. The program no longer exists; however, revenue from repayment of the UDAG loans can currently be used to fund CDBG-eligible activities—including economic development loans. The City of Springfield received four UDAG grants totaling \$17,373,290.

HOME Program

Created under Title II of the National Affordable Housing Act of 1990, the HOME Program is designed to: (1) expand the supply of decent and affordable housing to low income citizens and (2) extend and strengthen partnerships among all levels of government and the private sector in the production and operation of affordable housing. Annual HOME allocations to the City of Springfield for Federal fiscal years 1996 to 2001 totaled \$10,873,000 as follows:

<i>Fiscal Year</i>	<i>HOME Funds</i>
2001	\$2,091,000
2000	1,878,000
1999	1,878,000
1998	1,744,000
1997	1,622,000
1996	1,660,000
Total	\$10,873,000

Audit Objective

The overall audit objective was to determine whether certain loans were awarded in accordance with the City's policies, the City's procedures, and applicable HUD regulations.

Audit Scope and Methodology

To accomplish our audit objectives, we:

- Reviewed the applicable HUD regulations to gain an understanding of CDBG, HOME Program requirements and allowed usage of miscellaneous income generated by UDAG.
- Interviewed the City's managers and staff who administer the applicable Programs and reviewed City Policies and Procedures to understand procedures and controls over the programs.
- Reviewed the City's fiscal and program files for the 33 loans to determine if City policies and Federal requirements were followed in the processing of the applications and disbursements of the funds.
- Interviewed project owners to gain an understanding of the City's process from their perspective and obtain any additional documents.
- For transaction testing methodology, we used non-representational samples rather than statistically valid

samples. The non-representational sample methodology was appropriate because we were able to identify a relatively small number of loans from the allegations in local newspapers.

We conducted the audit from April 2001 to April 2003. The audit covers selected loans funded by CDBG funds, HOME funds, and UDAG revenue. The City made these loans between January 1, 1996 and March 31, 2001. Where appropriate, we extended the review to include other periods. The audit was conducted in accordance with generally accepted government auditing standards.



Mismanagement in the City's Business Improvement Program

The City's Business Improvement Program (BIP), principally funded from the Community Development Block Grant (CDBG) program, was not managed efficiently. Our review disclosed that:

- (1) The City disbursed funds for twenty-two projects without documenting compliance of key aspects of the City's program;
- (2) Files for nineteen projects lacked the documentation necessary to determine if the loans met a national objective; and
- (3) Procedures used to process loan applications and payment requests were not followed consistently, and this inconsistency produced an appearance of favoritism.

These deficiencies occurred, in part, because City officials did not follow: Federal requirements; its internal controls governing disbursements of funds; and its BIP policies. The City also misinterpreted requirements relating to documenting compliance with national objectives. As a result, we questioned \$187,699 of the \$205,308 that the City expended for BIP between January 1, 1996 and April 30, 2001.

City Fails to Follow its Own Policies

The City expended \$205,308 for 28 projects under its BIP between January 1, 1996 and April 30, 2001. Our review of the 28 BIP projects disclosed 22 projects totaling \$159,794 that did not comply with key aspects of the City's program policies. Many projects had multiple compliance violations. Deficiencies included:

- 1) Paying for costs based on proposals instead of bills for completed work;
- 2) Allowing costs for work completed prior to the letter of commitment;
- 3) Paying invoices provided by loan recipients without proof that loan recipients paid vendors; and
- 4) Paying for non-façade related items or labor contrary to the program objective.

BIP Program Funded through City's CDBG Program

The City principally used CDBG program funds to fund its BIP. As a grantee of the CDBG program, the City of Springfield is required to follow 24 CFR Part 85 Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments. This regulation establishes uniform administrative rules for Federal Grants and cooperative agreements and sub awards to State, local and Indian tribal governments.

Federal Law provides that applicable OMB cost principles, agency program regulations, and the terms of the grant and subgrant agreements will be followed when determining the reasonableness, allowability, and allocability of costs (24 CFR Part 85.20(b)(5)). The cost principles applicable to the City of Springfield's CDBG and HOME programs are provided in OMB Circular A-87 Cost Principles for State, Local, and Indian Tribal Governments. OMB Circular A-87 provides that allowable costs must meet certain general criteria, including but not limited to, consistency with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.

City Policies Define Eligibility of Activities and Expenditures

According to the City's written program policies, activities eligible for BIP funding include improvements to the facade of an existing office, retail or commercial building. The treatment can include restoration, rehabilitation, or installation of a compatible new storefront. Improvements can also include roof repair and any additional exterior improvements. The City reported these activities under the national objective of benefiting low and moderate income persons, including area benefit activities and job creation or retention activities.

In general, the City's policies provided that:

- 1) Projects must meet the approval of the City's Design Committee;
- 2) Applicants need to be up to date on all municipal taxes prior to participation in the program;
- 3) Disbursements need to be reimbursed for costs already incurred;
- 4) Applicants need to submit proof of payment for completed work;

- 5) Work completed prior to the letter of commitment is not eligible for funding; and
- 6) Funding is limited to the purchase of supplies and material and may not be paid for labor costs.

Federal regulations require the City to maintain accounting records that are supported by source documentation such as cancelled checks, paid bills, payrolls, time and attendance records, contracts and subcontract award documents (24 CFR Part 85.20(b)(6)).

The City did not Follow Policies for Disbursing \$159,794 in BIP Funds

We examined the supporting documentation involving \$205,308 in disbursements for the 28 projects reviewed. These projects concern 26 addresses as two addresses received funding for two projects in two different years. In violation of City policy, \$42,695 of the \$205,308 in disbursements was supported by proposals and not actual amounts.

<i>Disbursements Supported by Proposals</i>	
<i>Address</i>	<i>Amount</i>
1) 1195 Sumner Avenue	\$5,000
2) 18 Berkshire Avenue	\$378
3) 272 Bridge Street	\$5,000
4) 272 Worthington Street	\$10,000
5) 768 Main Street	\$10,000
6) 883 Sumner Avenue	\$5,000
7) 143 Main Street	\$7,317
<i>Total</i>	<i>\$42,695</i>

In violation of City policy, \$64,151 of the \$205,308 in disbursements was supported by costs incurred prior to the award.

<i>Work Completed Prior to the Commitment Letter</i>	
<i>Address</i>	<i>Amount</i>
1) 487 Main Street	\$4,900
2) 247 Hancock Street	\$10,000
3) 1295 Worcester Street	\$10,000
4) 18 Berkshire Avenue	\$9,622
5) 481-483 Belmont Avenue	\$10,000
6) 340 Main Street (1997 Award)	\$9,629
7) 170 Main Street (Indian Orchard)	\$10,000
<i>Total</i>	<i>\$64,151</i>

Finding 1

In violation of City policy, \$45,648 of the \$205,308 in disbursements was supported by invoices that did not include proof of payment.

<i>Disbursement without Proof of Payment</i>	
<i>Address</i>	<i>Amount</i>
1) 710 Liberty Street	\$4,250
2) 340 Main Street (1997)	\$371
3) 340 Main Street (1999)	\$3,863
4) 254 Worthington Street (1997)	\$10,000
5) 254 Worthington Street (1999)	\$4,978
6) 912 Main Street	\$10,000
7) 166 Eastern Avenue	\$4,503
8) 143 Main Street	\$2,683
9) 459 Dickinson Street	\$5,000
<i>Total</i>	<i>\$45,648</i>

An additional \$7,300 was questioned because of inadequate supporting documentation.

<i>Other Issues</i>		
<i>Address</i>	<i>Problem</i>	<i>Amount</i>
1106 State Street	Supported by applicant's handwritten list of items	\$3,750
232 Worthington Street	Invoices reflect lumber delivered to applicant's home address	\$2,413
340 Main Street	Invoices not related to the assisted business	\$1,137
<i>Total</i>		<i>\$7,300</i>

Supporting documentation for the remaining \$45,514 (\$205,308 - \$159,794) in disbursements was consistent with the City's disbursement policy.

City did not Document National Objective 19 Times

Disbursements from BIP must meet one of the three national objectives of the CDBG program: (1) directly benefit low and moderate income persons, (2) aid in the elimination or prevention of slums and blight, or (3) meet other community needs that have a particular urgency.

Files maintained for 19 of the 28 projects, representing \$151,158 (\$71,655 + \$79,503) in expenditures, did not demonstrate the achievement of a national objective. Ten files did not have any documentation of a national objective.

<i>No documentation of a National Objective</i>	
<i>Project</i>	<i>Award</i>
1) 459 Dickinson St.	\$5,000
2) 398 Dickinson St	4,640
3) 84 Maple St	5,000
4) 1195 Sumner Ave.	5,000
5) 858 State St.	4,515
6) 1106 State St	7,500
7) 1295 Worcester St.	10,000
8) 481-483 Belmont Ave.	10,000
9) 170-176 Main St, Indian Orchard	10,000
10) 340 Main Street (the 1997 award)	10,000
Total	\$71,655

Nine additional projects had insufficient documentation to demonstrate the achievement of a national objective.

<i>Insufficient Documentation for National Objective</i>		
<i>Project</i>	<i>National Objective</i>	<i>Award</i>
1) 912 Main St.	Area Benefit	10,000
2) 166-172 Eastern Ave.	Area Benefit	4,503
3) 143 Main St.	Area Benefit/Job Creation	10,000
4) 768 Main St.	Area Benefit/Job Creation	10,000
5) 18 Berkshire Ave.	Area Benefit/Job Retention	10,000
6) 247 Hancock St.	Area Benefit/Job Creation/Retention	10,000
7) 254 Worthington St. (the 1997 Award)	Job Creation	10,000
8) 1383 Main St.	Job Creation	10,000
9) 272 Bridge St.	Job Retention	5,000
Total		\$79,503

City Misinterpreted
National Objective
Requirements

The remaining nine BIP projects totaling \$54,900 were sufficiently documented to indicate the achievement of a national objective. The City funded one of these nine BIP projects with loan repayments from Urban Development Action Grant loans. Urban Development Action Grant funds originated from HUD.

As identified by HUD in its May 2001 monitoring report and acknowledged by the City in its response to HUD's report, the City misinterpreted program regulations. The City believed that any activity located in an Enterprise Community automatically benefited the residents who lived there. An Enterprise Community is an urban area designated by HUD pursuant to 24 CFR 597.3. This designation allows these communities to be eligible for tax incentives, tax credits, and special consideration for Federal assistance. HUD explained to the City in May 2001 that the City was incorrect as there must be a link between the assistance to the business and the benefit to area residents.

For six projects where the City claimed the national objective of area benefit, the City did not show a link between the assistance to the business and the benefit to area residents. For example, a May 2001 HUD report cited the 340 Main Street project (the 1997 award) for failure to demonstrate a link between the assistance provided to the business and benefit to area residents. In its response to HUD's report, the City provided, among other things, a description of the services provided to the area residents with a copy of a menu for the restaurant at 340 Main Street. While HUD accepted this documentation as support of the area benefit national objective, we disagree. The City's documentation supported the existence of the business, but did not demonstrate how the business benefited the low or moderate income community members.

City's Projects did not
Create or Retain Jobs as
Claimed

For seven projects where the City claimed the national objective of either job creation or job retention, the City did not support its claim. The files provided for the projects located at 247 Hancock Street, 1383 Main Street, and 768 Main Street indicated a national objective of job creation or job retention. These files did not justify such a claim with any supporting records such as:

- 1) A listing by job title of the permanent jobs created/retained and held by low or moderate income persons;
- 2) Job agreements; and
- 3) The size and annual income of the person's family prior to being hired.

The documents contained in the files provided for the remaining four projects is inadequate based on the following:

- 143 Main Street – For a \$10,000 contract dated April 1998, the City's documentation consisted of a September 8, 2000 memo from the business indicating two full time jobs were created with a job title and name. The file did not contain a job agreement or any evidence to support that the jobs were filled by low or moderate income persons.
- 18 Berkshire Avenue – For a \$10,000 contract dated August 1, 1997, the City's documentation of national objective consisted of an April 2, 1998 letter from the business stating that the assistance will enable them to create two additional jobs. The scope of services in the August 1997 contract indicates that the assistance will retain three jobs. This file does not contain any job agreements, or listing of jobs retained and held by low or moderate income persons.
- 254 Worthington Street (the 1997 award) – For a \$10,000 contract dated July 7, 1997, the City's documentation consisted of a 1997 job agreement as well as two signed job certifications dated June 6, 2001. The certifications are signed by individuals claiming to be low to moderate income that work at the assisted business. When we interviewed the business's office manager to obtain documents to support the claim, we were told that the business did not have applications or tax withholding forms for these low or moderate income employees.

Inconsistencies have
Appearance of Favoritism

- 272 Bridge Street – For a \$5,000 contract dated September 1, 1998, the City’s documentation consisted of a September 23, 1998 letter from the business stating that three (3) jobs will be lost without the assistance. This file does not contain any job agreements, or listing of jobs retained and held by low or moderate income persons.

In addition, we identified inconsistencies in the processing of loan applications and requests for payments that had the appearance of favoritism. One of the City’s internal controls is to have the Commissioner of Community Development sign all contracts funded with BIP. In interviews, he stated that he places a “p” next to his signature on contracts with which he has a problem. As Commissioner, he has the option of not signing off on any contracts he feels are problems. We identified this notation next to the Commissioner’s signature on five BIP contracts:

- ◆ 272 Bridge Street
- ◆ 340 Main Street
- ◆ 272 Worthington Street
- ◆ 83 Sumner Avenue
- ◆ 1209 Sumner Avenue

Payments to 272 Bridge
Street Expedited Despite
Tax Delinquency

In 1997, a BIP project manager prepared an Application Process and Timeframe memo. This memo identified that the turnaround time from application to contract would take two to four weeks. Disbursements take additional time. For the 272 Bridge Street project, the total time from application to disbursement for the project located at 272 Bridge Street was six weeks from the application dated August 13, 1998 to the disbursement dated September 25, 1998.

Additionally, at application, the property had an outstanding tax delinquency of \$32,237. On August 13, 1998, the owner applied for \$5,000 to install windows. On September 24, 1998, the City’s Planning Department advised that, if this project is selected for funding, then it should be presented to the Historic Commission as part of a formal review process. This September 24, 1998 memo also identified that 272 Bridge Street was tax delinquent.

City Files Indicate Personal
Delivery of Disbursement

Despite the requirement that all applicants be up to date on all municipal taxes prior to participation, the City disbursed \$5,000 on September 25, 1998 to the project owner who was tax delinquent. City files indicate that the check for 272 Bridge Street was handed to the Mayor's Chief of Staff for delivery to the project owner.

Neither Delinquent Taxes
nor the BIP Loan were
Fully Repaid

In an email dated September 15, 1998, the City Treasurer stated that the project owner entered into a satisfactory payment agreement with the City regarding outstanding real estate taxes. This agreement is not included in the City files. In an electronic mailing dated June 6, 2001, the Program Manager asked the City Treasurer for the repayment agreement. The City Treasurer replied that there was no agreement; but the taxes were paid in full on September 21, 2000. Records in the City files indicate that on September 11, 2000 *"the City as (sic) agreed to accept \$43,000 of the \$63,000 owed in real estate taxes."* Additionally, around September 2000, the 272 Bridge Street owner went out of business and paid only \$2,144 of the \$5,000 BIP loan.

For the loan for 272 Bridge Street, the City expedited processing to an ineligible property through hand delivery of the payment to an owner who went out of business paying neither the entire loan nor the entire tax delinquency.

764-770 Main St.
Received \$10,000 BIP
Loan after \$175,000
UDAG Loan

In December 1998, the City loaned \$10,000 to 764-770 Main Street to purchase windows cited in a September 1998 application. In April 1998, the City used UDAG funds to loan this business \$175,000. In April 1998, the owners also applied for and received another \$175,000 from a bank to rehabilitate 764-770 Main Street. The BIP application made no reference to the prior loans. However, the scope of services in the BIP contract identifies that the owner was performing major renovations to the building with the acquisition and rehabilitation costs estimated at \$375,000. The City should have addressed the question of whether the windows were part of the \$175,000 in rehabilitation costs during the processing of the \$10,000 BIP award.

Despite the requirements that:

- (1) disbursements may only be reimbursed for costs already incurred,
- (2) applicants need to submit proof of payment for completed work and
- (3) work completed prior to the letter of commitment is not eligible for funding,

the City disbursed \$10,000 in December 1998 for a project with a November 1998 letter of commitment supported only by a May 1998 proposal.

City's Evaluation of Application Identifies Concerns

In a memo dated October 28, 1998, the City's Planning Department advised the Program Manager that the September 1998 application was too vague to render an opinion and the project was under way prior to the application. During our review, the Planning Department stated, in a memo dated June 11, 2001, that they had no record of granting final approval for this project.

City Employee Denies Conducting a Monitoring Visit

The City's files contained a monitoring report for 764-770 Main Street indicating that the assigned Program Monitor conducted an on-site monitoring visit on August 4, 2000—twenty-two months after paying the property owner. This monitoring report indicated that the work was completed and that the project owner satisfied its contractual obligations in compliance with Federal requirements. In our discussions with the Program Monitor listed on the report, the Program Monitor stated that he did not conduct an on-site review.

Two Businesses Displaced while two Different Businesses begin

Our review disclosed that the building was owned and occupied by a hardware store prior to the April 1998 acquisition by the current owner. This acquisition was funded through a \$175,000 UDAG loan and is discussed in our finding titled Economic Development Loans did not meet Program Requirements. During a March 14, 2002 interview, the owner of the hardware store indicated that he was approached with an offer to purchase his building in December 1997. Although initially reluctant, he accepted the offer. In conjunction with the sale, the owner closed the hardware store and displaced his tenant, a flooring business. After the sale, a gift store and hair salon began to occupy the building.

City cannot Support
Achievement of a
National Objective

The City reported that 764-770 Main Street would achieve the national objectives of: (1) benefit to low to moderate persons based on service area and (2) job creation. Since the City did not take into account: (1) the jobs lost as a result of closing the hardware store and flooring business or (2) whether a hardware store would serve low income residents better than a gift store; achievement of a national objective is questionable. Furthermore, the City's files contained no documentation to support the achievement of either national objective.

No Fire Damage at 764-
770 Main Street

The City's project summary claimed that 786 Main Street was vacant as it suffered severe fire damage and that the current owner of the business purchased the building and substantially rehabilitated it. The current owner of 786 Main Street also owns 744 Main Street. According to the person who owned 764-770 Main Street in 1998, prior to the sale to the current owner, it was the 744 Main Street property that suffered the fire damage. According to City files, the current owner also submitted an application for BIP funds for 744 Main Street in 1998. The City found 744 Main Street to be ineligible for BIP funding on the basis that the project was already completed.

For 764-770 Main Street, the City made a second loan to a business based on a vague application. The City did not require proof of payment nor did they have evidence that the business incurred the costs or if the costs were independent of the first loan. These funds helped to displace two businesses while assisting two different businesses without the achievement of a national objective.

City Paid for Labor Costs
at 254 Worthington Street

The project located at 254 Worthington Street received two BIP awards: one in 1997 totaling \$10,000 for an outdoor patio, and a second in 1999 totaling \$5,000 for signage. We found inconsistencies with the 1999 award. To support the \$5,000 disbursement, the City used an invoice for a sign provided by the project owner. Our review of the City's program files disclosed that this invoice contained a notation stating that the amount approved for payment was \$3,550 for the materials only. Upon review of the Fiscal Director's files, we found that the invoice noted, "*Pay \$5,000*". When asked for an explanation, the Fiscal Director advised that he was directed to pay \$5,000 by either the Program Manager or the Compliance Director; but could not recall which one.

Payment of labor for an applicant is contrary to City policy. City staff ensured payment of \$5,000 when only \$3,550 was eligible. Furthermore, applicants are required to submit proof of payment prior to the City's reimbursements. The City did not apply this policy to 254 Worthington Street.

City's BIP Loan
Duplicates City-funded
GSEF Loan

During our audit, we found that 254 Worthington Street received two additional loans, totaling \$50,000, in early 1998 from another Federally funded loan pool—the Greater Springfield Entrepreneurial Fund (GSEF). The application for one of the GSEF loans identifies that the purpose of the loan was to construct an outdoor all-season patio. GSEF received part of its funding from the City. The City used CDBG, and UDAG funds to assist GSEF.

For 254 Worthington Street, the City made two loans while a City sub-recipient made two additional loans. For one of its loans, the City paid for ineligible labor costs and did not require the applicant to submit proof of payment; thereby avoiding the internal control designed to find the discrepancy.

City did not Apply
Policies to 272
Worthington Street

In March 1999, the City provided \$10,000 to the project owner of 272 Worthington Street to purchase supplies and materials for business improvements. The partnership that owns 272 Worthington Street includes the individual who owns 254 Worthington Street. The City documented the disbursement for 272 Worthington with a proposal for work contrary to the requirement that the applicant submit proof of payment. Our interview with a former Project Manager disclosed that the former Project Manager advised that the application was incomplete and must be fixed before any funds could be provided. The former Project Manager stated that the project owner went to a higher City employee. After the project owner complained, processing for this loan was reassigned to the Program Manager who subsequently processed the loan. During our review, we found that 272 Worthington Street also received two additional loans, totaling \$50,000, in December 1999 from the GSEF loan pool for business improvements.

City Monitoring Report lists Awning Installed, but no Awning Present

The City's file contained an undated, unsigned on-site monitoring report. The report indicated the rehabilitation was complete, that the awnings and signage for the vacant storefront had been purchased and installed. Our observation of this project in July 2001 established that no awnings were present. City staff that visited the property should have noticed the missing awnings.

For 272 Worthington Street, the City made a loan for awnings and signage while a City subrecipient made two additional business improvement loans. For its loan, the City did not require proof of payment contrary to its policies. Visual inspection of the project exterior showed that no awnings were present.

City did not Apply Policies to 883 Sumner Avenue Project

The City provided \$5,000 to 883 Sumner Avenue after the City's former Project Manager determined that the project was ineligible. The Project Manager notified the Program Manager that the applicant had completed most of the work outlined in the application prior to the project's approval for BIP. City policies state that work completed prior to the letter of commitment is not eligible. Additionally, the City did not require proof of payment before making disbursements, as required.

Inconsistencies in Processing of 1209 Sumner Avenue Project

Files maintained for the project located at 1209 Sumner Avenue contained inconsistencies. First, the invoice for payment maintained in the Program Manager's files contained a notation from the Program Manager that \$4,950 was approved for payment. The invoice maintained in the Fiscal Director's files does not contain this notation, but instead states: "*Pay \$5,000*" on the invoice.

Two City Offices have Different Contracts for two Projects

For two projects, 1209 Sumner Avenue and 232 Worthington Street, the contract in the City Auditor's office differed from the contracts held by the Compliance Director and Fiscal Director. The City Auditor's office had a contract for 1209 Sumner Avenue where the scope of services identifies that the assistance will result in the creation of three new full-time jobs and three new part-time jobs. This contract scope differs from the contract scope retained by Compliance Director and Fiscal Director. The scope of services attached to this contract provides that the assistance will result in the creation of one full-time job.

The City Auditor's office had a contract for 232 Worthington Street where the scope of services to this contract identifies that 15 jobs will be retained and one new full-time position will be created as a result of the City's assistance. The scope in this contract differs from the scope in the contract retained by Compliance Director and Fiscal Director. The scope of services attached to that contract identifies that the assistance will result in the creation of one full-time job. It does not provide for the retention of 15 jobs.

As a result of these actions, the City utilized \$159,794 for ineligible project disbursements and \$27,905 for projects whereby achievement of a National Objective is questionable. If City officials followed Federal requirements; their established internal controls governing disbursements of funds; and their BIP policies, an additional \$187,699 would be available to eligible businesses in Springfield.

Auditee Comments

The \$187,699 in BIP funds questioned by the auditors represents less than one per cent of the \$30,969,000 in CDBG funds allocated to the City during the review period from 1996 to 2001.

The City believes it is important to note that the BIP program was part of a comprehensive monitoring review conducted by that the Department of Housing and Urban Development (HUD) in Boston in 2000-2001, which identified several "Findings" relative to the program. The City states that it responded to each Finding to HUD's satisfaction, and the Findings were subsequently closed. In May 2001, HUD determined that the City was "adequately managing its Business Improvement Program (façade) portfolio."

The City's response addresses the auditors' contentions in the draft report, explaining that the City's own guidelines for the BIP program evolved over time in an effort to improve the program's efficiency and effectiveness. Divergence from these discretionary policies did not violate any state or Federal statutes or regulations

The City also believes it is also important to mention that the majority of the BIP loans have been repaid to the City. The BIP program was structured as a partial loan and partial grant funding arrangement. The total funds loaned

were \$132,749.40; the total amount granted was \$72,918.44. As of September 10, 2003, the City had received a total of \$138,975.32 in repayments (this amount represents principal and interest). The City has also been able to recapture \$6,539.60 in grant funds where the City determined project costs were ineligible. The remaining loan balance is \$33,661.49. The City continues to receive payments and exercise collection activities where feasible.

The City believes that BIP projects reviewed by the auditors were eligible for CDBG funding and met national objectives at the time funding decisions were made. The City has acknowledged that its management of the BIP program was at times inconsistent, but as a result of HUD's monitoring and technical assistance, the City implemented several changes to its management and oversight of the program to avoid these problems in the future. Ultimately, however, the BIP program proved unworkable and it was discontinued by the City.

OIG Evaluation of Auditee Comments

We acknowledge that the funds questioned is a small percentage of the CDBG funds allocated to the City; however we conducted a limited review that focused on specific projects where local media sources had reported complaints. HUD has a limited amount of CDBG funds available and all usage of these funds must meet program objectives. OIG is questioning 28 specific BIP loans as delineated in Appendix B. The review by OIG is more comprehensive than the review conducted by HUD and included examination of third party documentation and interviews with loan recipients.

The City contends that divergence from its discretionary policies did not violate any state or Federal statutes or regulations. The City of Springfield is subject to OMB Circular A-87 Cost Principles for State, Local, and Indian Tribal Governments. OMB Circular A-87 provides that allowable costs must meet certain general criteria including consistency with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit. This circular is implemented in 24 CFR part 84—a Federal regulation. As stated in our audit report, the City did not meet these criteria.

Additionally, the City highlights that many of the questioned loans have been repaid. When a loan is ineligible, repayment of the loan does not make that loan eligible for funding.

Recommendations

We recommend that you:

- 1A. Require the City to repay \$159,794 in ineligible costs from non-Federal sources.
- 1B. Require the City to repay \$27,905 in unsupported costs or document the eligibility, the national objective, and propriety of these expenditures.
- 1C. Ensure implementation and usage of adequate management controls so that City and HUD requirements are met.
- 1D. Require that the City explain its actions with regard to the loans.
- 1E. Take appropriate administrative sanctions, where merited.

Community Development Loans did not Meet Program Requirements

Our review of three community development loans, totaling \$360,000, disclosed that the City lacked documentation to determine if the loans met program requirements. The City did not evaluate these projects in accordance with its underwriting guidelines. The files did not include basic documentation such as applications, award determinations, and commitment letters. In addition, the files did not demonstrate achievement of national objectives; nor did the files contain the City's evaluation of projects. One of the loans was provided to an entity managed by City employees. Additionally, two of the loans were provided to individuals/entities who also benefited under the BIP. These deficiencies occurred, in part, because the City did not follow its underwriting guidelines. Also, the City's guidelines do not provide procedures for documenting the achievement of a national objective, as required. Because of the nature and extent of the deficiencies, the loans are ineligible.

City used UDAG
Miscellaneous Income &
CDBG Funds for Loans

The City provides community development under several programs including an Economic Development program and a Public Service Program. The Economic Development Program provides financial assistance to individual businesses to encourage business development, growth, and expansion. Our review examined two economic development loans totaling \$210,000 and one public service loan totaling \$150,000.

One economic development loan for \$175,000 was funded through miscellaneous income generated by the Urban Development Action Grant (UDAG). The City funded the second economic development loan for \$35,000 through the Community Development Block Grant (CDBG). The City funded the public service loan for \$150,000 through the CDBG.

City and Bank *each*
Provided \$175,000 to
Purchase 770 Main Street

In April 1998, the City awarded a \$175,000 loan for the acquisition of property located at 770 Main Street. In addition to the \$175,000 loan from the City, the borrower obtained a \$175,000 bank loan. The \$175,000 City loan was used for the acquisition of the building while the \$175,000 bank loan was used for rehabilitation costs.

Usage of UDAG
Miscellaneous Revenue
must be Eligible

Title 42 Chapter 69 Section 5318(f) Urban Development Action Grants refers to Section 5305 Activities eligible for assistance which allows provision of assistance to private, for-profit entities, when the assistance is appropriate to carry out an economic development project (that shall minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods) that—

- (A) Creates or retains jobs for low- and moderate income persons;
- (B) Prevents or eliminates slums and blight
- (C) Meets urgent needs;
- (D) Creates or retains businesses owned by community residents;
- (E) Assists businesses that provide goods or services needed by, and affordable to, low- and mod-income residents; or
- (F) Provides technical assistance to promote any of the activities under subparagraphs (A) through (E)

\$175,000 Loan did not
Comply with Eligibility
Requirements

The City did not ensure that its \$175,000 loan complied with the Title 1 Eligibility requirements. Specifically, the City files do not establish the achievement of any eligibility factor such as the creation or retention of jobs, businesses providing goods affordable to low-income residents or retention of businesses owned by community residents. We also found no evidence that the City exercised prudent lending practices. For example, the project files did not contain loan applications, financial statements, credit reports, or business plans. We found no analyses of the entity's economic viability, financial needs, or proposed use of the funds in meeting program objectives.

Assistance Displaced
Existing Businesses

Our review also disclosed that the assistance resulted in the displacement of two existing businesses. The previous owner of 770 Main Street owned and operated a hardware store at that location for over 40 years. Before the 1998 sale, a flooring company was also a tenant of the property. The previous owner advised that he initially had no intention of selling his property, but was persuaded by the current owner. As a result of the sale, two active businesses were eliminated and two new businesses were created. The City did not document that the new businesses—a gift shop and a hair salon—would better serve the needs of a low-income neighborhood than the

displaced businesses—a hardware store and a flooring company.

City Provided \$35,000 to Purchase 467 Dickinson Street

In May 1998, the City loaned \$35,000 in CDBG funds, which the applicant used to acquire 467 Dickinson Street, a condemned, tax delinquent house. This house was demolished at the City's expense. The owner turned the property into a parking lot.

Usage of CDBG Funds must meet Requirements

Usage of CDBG funds is governed by Title 24 CFR 570 Program Requirements. These regulations require that each usage of funding must meet one of three national objectives and the City must document which national objectives each usage of funds meets. When loaning CDBG funds, the City must: 1) determine that the assistance would not be excessive or otherwise enrich the owners, 2) perform a pre-loan analysis of the business' unmet needs from private funding sources, 3) evaluate the public benefit, and 4) evaluate the projects' financial feasibility and likelihood of success.

City did not Ensure that Loan met Requirements

The City did not determine whether the 467 Dickinson Street loan met program requirements and national objectives. We also found no evidence that the City exercised prudent lending practices. For example, the project files provided by the City did not contain loan applications, financial statements, credit reports, or business plans. We found no analyses of the entity's economic viability, financial needs, or proposed use of the funds in meeting program objectives.

City Planned to Forgive \$20,000

Our review of the 467 Dickinson Street loan disclosed that the City would forgive \$20,000 if the owner occupied the premises for ten years. The contract between the City and the owner of 467 Dickinson Street, dated May 1, 1998, stated that the repayment terms are listed in the promissory note. The City could not provide the promissory note. City officials were certain a promissory note was executed and advised that they would prepare a new promissory note. The City provided a promissory note dated September 27, 2001 on September 27, 2001.

City Condemns and Razes 467 Dickinson Street for Health and Safety reasons

On September 27, 2001, the City also provided documents showing the condemnation and demolition of the 467 Dickinson Street including:

- 1) A memo dated December 7, 1998 from the City's Building Department stating that the property was condemned for health and safety reasons based on a visual inspection by a Building Department employee.
- 2) An Order of Condemnation dated December 7, 1998 where the Mayor ordered the property demolished.

Our review of a list of 1999 Demolition Accomplishments shows that the buildings at 467 Dickinson Street were demolished in February 1999 at a cost of \$20,150. The City used CDBG funds to pay for the debt service on the City bond for Demolition.

Owner cannot Occupy a Demolished Building, yet City Forgives \$20,000

The promissory note between the City and the owner of 467 Dickinson Street sets up a repayment schedule whereby the owner will pay \$1,500 a year for ten years. This schedule also states that the balance of \$20,000 will be forgiven after ten years if the property remains owned and occupied for an uninterrupted period of ten years. Since the property is a parking lot, it is impossible for the owner to occupy it according to the terms of the promissory note. Additionally, the annual invoice for payment from the City to the owner showed the loan total of \$15,000—as if the \$20,000 has already been forgiven.

City Loaned \$150,000 to Non-Profit Managed by City Employees

The City loaned \$175,000 to a non-profit entity located at 619 State Street. The City disbursed \$150,000 of this loan between June 2000 and January 2001. The City entered into a contract with the non-profit, which states that the time of performance is July 1, 2000 to June 30, 2001. The purpose of the contract was “to provide financial assistance to the [non-profit] for costs associated with the operation of its day care center.” In August 2001, the non-profit repaid this loan.

The City's community development efforts are conducted by and through its Office of Community Development. The Office of Community Development is responsible for the administrative functions for the Community Development Block Grant, HOME Investment Partnership, and Emergency Shelter Grant programs. The City's Office

of Community Development, Office of Economic Development, and Office of Housing are each charged with program implementation and are accountable for performance.

Costs Charged to Federal Awards Must Meet General Criteria

OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments provides Basic Guidelines, including factors affecting allowability of costs (Attachment A, Paragraph C, *Basic Guidelines*). To be allowable under Federal awards costs must meet general criteria, including, but not limited to, the cost must be reasonable, necessary, adequately documented, and allocable to a cost objective in accordance with relative benefits received.

Expense did not Meet Federal Requirements

The contract between the City and the non-profit did not identify how the non-profit would allocate the loan proceeds to actual cost items or program objectives. Instead, the contract included a document titled *“Daycare Budget July 1, 2000 – June 30, 2001.”* It is unclear how the residents of Springfield benefited from the loan.

Despite repeated requests, the City was unable to provide: 1) an application for funds; 2) award approvals; 3) the planned use of the loan; 4) monitoring reports; and 5) documentation showing how the loan met national objectives.

National Objective Not Demonstrated

According to City Officials, the national objectives were in the scope of the contract. The scope of the contract states:

“The benefits of this activity are two-fold. First the funding will enable [non profit] to continue its operations of the day care center to prevent job loss, retaining twenty-six (26) jobs, at least 51% of which will benefit low moderate income persons. Second, [non profit] provides needed and necessary day care services to low moderate income families.”

City Employees Managed Non-Profit Loan Recipient

The City’s Director of Housing acted as Interim Operations Manager for this non-profit during the period July 1999 through September 2000. Also, the City’s Chief Financial Officer is the Treasurer of this non-profit and has been since July 1999. The Director of Housing/Interim Operations Manager stated that the non-profit reimbursed

the City for a portion of the salary earned as Director of Housing because this salary was increased to reflect the additional duties to act as Interim Operations Manager of the non-profit. Signing the contract for the City was the Chief Financial Officer who is also Treasurer of the non-profit. The Chief Financial Officer/Treasurer also signed the check for the first disbursement of \$130,000. The City's files identify that this check was given to the Chief Financial Officer/Treasurer.

Conflict of Interest

Federal regulations at 24 CFR 570.611 state that participants in the decision-making process may not: (1) obtain a financial benefit from CDBG assistance, or (2) have a financial interest in any contract assisted through CDBG. These regulations specifically apply to any employee of the City. The two City employees who officiated as the Interim Operations Manager and the Treasurer of the non-profit had a financial interest in the \$150,000 loan the City made to the non-profit.

Auditee Comments

The City maintains that each of the loans identified in Finding #2 met the applicable eligibility requirements and, where applicable, also satisfied national objectives.

For the 770 Main Street loan, the City contends that the auditors applied the wrong standards for review, since the loan funds were miscellaneous revenue from a repaid UDAG loan, which are not subject to the regulatory requirements cited in the draft report.

Regarding 467 Dickinson Street, the City contends funds were used for the acquisition of a blighted, condemned three-family house, which was then demolished to make way for expanded parking for a neighborhood restaurant, allowing expansion of the business and the creation of additional jobs for low and moderate income persons.

The City believes the most egregious portion of the draft report, however, is the section criticizing the City's \$150,000 loan to the Daycare Program at a non-profit community action agency at 619 State Street. The auditors decided the nonprofit did not need the loan money, and that no jobs were saved by the financial assistance, because a projected budget attached to the loan agreement projected a "profit". The auditors also made meritless conflict of

interest allegations against two City department heads who stepped in at the request of state officials to help save the non-profit community action agency from being decertified and having its state funding terminated.

OIG Evaluation of Auditee Comments

For 770 Main Street, the City believes that its 1984 Closeout of a UDAG grant and a 1991 HUD Handbook govern the loan to 770 Main Street. The City made this questioned loan in 1999 and neither of these criteria was in effect at that time. At January 20, 1999, 42 USC 5318 was effective. Title 42 Chapter 69 Section 5318(f) Urban Development Action Grants refers to section 5305 of this title for eligible activities.

The recipient of the 770 Main Street loan is a private, for-profit entity. Section 5305(a)(17) of the title provides:

Provision of assistance to private, for-profit entities, when the assistance is appropriate to carry out an economic development project (that shall minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods) that--

- (A) Creates or retains jobs for low- and moderate income persons;*
- (B) Prevents or eliminates slums and blight;*
- (C) Meets urgent needs;*
- (D) Creates or retains businesses owned by community residents;*
- (E) Assists businesses that provide goods or services needed by, and affordable to, low- and moderate income residents.*

With this loan, the recipient eliminated two existing businesses and brought in two new businesses. Additionally, the City did not require the loan to meet any of the criteria listed in (A) to (E).

For 467 Dickinson Street, The City provided assistance in May 1998 and condemned the property in December 1998—six months after providing the assistance. Seven months later, the City changed the zoning for this site from residential to commercial in June 1999. Both the condemnation and the zoning change were necessary to build the parking lot. Logically, the property would have needed to be condemned and the zoning change approved before the City made this loan. The City also contends that this loan

provided jobs, yet the City has not supported the creation of new jobs. Without job agreements between the City and the loan recipient at the time of assistance, the City cannot assure HUD that these are new jobs or simply replacements of existing jobs

For 619 State Street, OIG disagrees with the City's contentions that there is no conflict of interest and this loan is eligible because:

1. The Director of Housing received a \$15,000 stipend from the City. The City acknowledges that this Agency reimbursed the City for this \$15,000. The Office of Housing is charged with program implementation and is accountable for performance.
2. The City has not documented the national objective of limited clientele
3. The City has not documented the national objective of job retention. The City's statements contain conflicting data on the number of jobs retained. The number of jobs retained is not supported by independent documentation.

The City provided sufficient independent documentation to assure us that this daycare operation was not profitable. Accordingly, we have edited our report to eliminate the concept that this operation was profitable.

Recommendations

We recommend that you:

- 2A. Require the City to develop and implement written procedures for documenting files, monitoring recipients, and enforcing compliance.
- 2B. Require the City to reimburse the CDBG program and UDAG miscellaneous income account from non-Federal sources for \$210,000 expended on projects that did not meet program objectives.
- 2C. Determine if the City appropriately handled the \$150,000 repayment from the project at 619 State Street.

- 2D. Require the City to show how the \$150,000 Public Service loan met the requirements of the CDBG program.
- 2E. Determine if loan proceeds for 619 State Street were used to compensate City Employees and take appropriate action to address the conflict of interest.
- 2F. Ensure that the nonprofit reimbursed the City for the compensation earned by the Director of Housing as Interim Operations Manager of the non-profit.
- 2G. Require that the City provide support for its actions with regard to these loans.
- 2H. Take appropriate administrative sanctions, where merited.



HOME Program Requirements not Met

The City did not ensure that: 1) HOME program affordability requirements were met, 2) the assistance did not unduly enrich the project owner; 3) disbursements were made in accordance with Federal program policy for eligible costs; and 4) City program policies governing disbursements were followed. Our examination of two projects, totaling \$126,495, found that neither project was completed according to the original scope of rehabilitation work. These deficiencies occurred, in part, because City officials did not follow Federal requirements or their own internal controls governing disbursement of funds. As a result, expenditures of \$126,495 are ineligible.

City uses HOME to Make Loans for Rental Housing and Homeownership

The City utilizes HUD's HOME program to fund activities that further the objectives of its Comprehensive Housing Affordability Strategy including: 1) Promotion of Homeownership; 2) Promotion of the rehabilitation of rental units for low-income and very low-income families; 3) Rehabilitation assistance to low-income homeowners; and 4) Tenant-based rental assistance to the homeless and special needs population. We examined two projects funded with HOME: (1) a homeownership property located at 222 Orange Street assisted with \$46,000 in HOME funds and (2) a rental housing project located at 807 Liberty Street, assisted with \$80,495 in HOME funds. During the course of our review the owner of 807 Liberty Street repaid the disbursed funds to the City.

Loan for 222 Orange Street did not Meet Requirements

The 222 Orange Street homeownership project: 1) did not meet HOME Program affordability requirements; 2) received HOME assistance that may have unduly enriched the project owner/developer; and 3) was not completed in accordance with the scope of the project. In addition, the project owner/developer received the unspent rehabilitation funds as a developer's fee. As a result of these deficiencies, the entire \$46,000 HOME award is ineligible.

HUD Requires that 222 Orange Street be Affordable for 15 Years

When HOME funds are used for homeownership projects, the assisted property must be purchased by a low-income family whose annual income does not exceed 80% of the median income for the geographic area (24 CFR Part 92.254(a)(3)). Any HOME funds invested in housing that does not meet the affordability requirements for the required period must be repaid by the City (24 CFR Part 92.503(b)(1)). Under affordability requirements at 24 CFR

92.252, 222 Orange Street must be affordable for fifteen years. In addition, the contract between the City and the property owner states that the developer agrees to transfer the property within three months of completion of the property's construction to a buyer in which the household income does not exceed 80% of the area median income adjusted for family size.

Homebuyer's Income Exceeds HOME Program Limits

According to the Completion Report for 222 Orange Street, the property was sold for \$59,000 to a family of four whose income was calculated at 115% of the area median. As HOME regulations limit family income to 80% of the area median, this family did not qualify for HOME funds. Since the City's files document that the project was not sold as affordable housing, the entire \$46,000 loan is ineligible.

HOME Assistance Unduly Enriched Project Owner

Furthermore, our review disclosed that the assistance unduly enriched the project owner. According to the contract between the City and the project owner, total development costs were \$46,000. The project owner sold the house for \$59,000. When funding homeownership projects, the City provides gap financing where the gap is the difference between the total development costs and the expected sale proceeds. Upon sale of the property, the owner retained the sale proceeds of \$59,000 and was not required to repay any of the \$46,000 grant. Since the sale proceeds exceeded the development costs, no gap in financing existed.

City let Owner Keep Proceeds for Costs Incurred Before HOME Existed

Upon inquiry, the City's Director of Housing explained the owner had incurred acquisition costs. The owner acquired 222 Orange Street in 1986—over ten years earlier. HOME regulations allow pre-award costs up to 25% of the current year's allocation, which may be charged to the following year's allocation. The regulations do not provide for costs incurred ten years prior to the award. In fact, the HOME program did not exist in 1986.

Sale Proceeds Exceeded Mortgage Amounts by \$38,000

Furthermore, we determined that 222 Orange Street and another property, 31-33 Woodlawn Street shared a first and only mortgage for \$95,000 executed in July 1995. When the owner applied for HOME funds in January 1996, this was the only outstanding mortgage. The owner sold 222 Orange Street for \$59,000 on November 13, 1997 and sold 31-33 Woodlawn Street sold for \$74,000 on July 14, 1998.

The sale proceeds from these two properties exceeded the mortgage amount by \$38,000.

	<i>Excess Proceeds</i>
\$59,000	Sale Proceeds - 222 Orange Street
<u>Add: \$74,000</u>	<u>Sale Proceeds - 31-33 Woodlawn Street</u>
133,000	Subtotal
<u>Less: \$95,000</u>	<u>Mortgage for both properties</u>
<u>\$38,000</u>	<i>Excess Proceeds</i>

City Allowed Owner/
Developer to Receive
HOME Funds as Fee

In a September 18, 1996 memo from the owner/developer to the City, the owner/developer stated that he expected to complete the approved scope of work at an amount less than the budgeted cost. He asked if he could reclassify expected savings as a developer's fee. The City approved this request in a memo also dated September 18, 1996. The City awarded \$46,000 to the owner of 222 Orange Street based on specific cost items that the City Inspector identified as necessary rehabilitation items. The \$46,000 included \$17,615 for plumbing and heating. This amount was based on a proposal from a plumbing and heating contractor who used the specifications prepared by the City Inspector. The plumbing estimate included renovations to the first floor bathroom, the second floor bathroom, and plumbing on the third floor.

City paid Developer's Fee
Despite Incomplete Work

On October 6, 1997, the City made the final disbursement paying the remaining grant funds of \$4,225 to the owner/developer as a Developer's fee. Review of the City's project files, relating to the subsequent sale of 222 Orange Street, indicates that the two bathrooms were not rehabilitated according to contract. Discussions with the owner/developer confirm that work was incomplete. Had the City properly monitored the project rehabilitation work, the project could have been completed properly and timely. Additionally, the fee paid to the developer could have been used to complete the scheduled plumbing.

Loan for 807 Liberty Street
did not Meet Requirements

HOME funds disbursed in connection with the 807 Liberty Street project were made contrary to Federal program policy and for ineligible costs. Our review also disclosed several unexplained deviations from City program policy governing disbursements. Additionally, we found that the project was not completed according to the original scope of rehabilitation work. As a result of the deficiencies disclosed, the \$80,495 in HOME funds disbursed in

connection with the project is deemed ineligible. During the course of our review, the owner of 807 Liberty repaid \$81,000, which exceeds the \$80,495 disbursed.

HOME and City Identify Requirements for Allowable Costs

As a grantee of the HOME program, the City is required to follow 24 CFR Part 85 Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments. This regulation requires that the City follow applicable OMB cost principles, agency program regulations, and the terms of the grant and subgrant agreements when determining the reasonableness, allowability, and allocability of costs. To be allowable under Federal awards, costs must meet certain general criteria, including consistency with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit. Federal regulations also require the City to maintain accounting records that are supported by source documentation such as cancelled checks, paid bills, payrolls, time and attendance records, contracts and subcontract award documents, etc. (24 CFR Part 85.20(b)(6)). City policy requires the City to make disbursements on a reimbursement basis and obtain proof of payment as a condition of disbursement.

City paid Ineligible Costs of \$29,110

The City paid \$29,110 of the \$80,495 for expenses related to 807 Liberty Street that are not eligible under the HOME Program, including back and current real estate taxes, mortgage payments, and property insurance:

<i>Expense Item</i>	<i>Ineligible</i>
Back Taxes	\$22,000
Current Taxes	2,225
Mortgage Payments	4,025
Property Insurance	860
Total	\$29,110

The City disbursed \$7,110 of the ineligible \$29,110 on December 7, 2000 for current taxes, property insurance, and mortgage payments. We determined that the owner used the November 9, 2000 HOME disbursement of \$33,505 to pay the City for taxes and sewer charges of \$22,000.

Project Owner Claims
Award Conditioned on
Payment of Back Taxes

According to the project owner, the HOME award was contingent on his remittance of \$22,000 to the City for a partial payment of back taxes and water/sewer charges. According to the owner, he owed over \$60,000 in back taxes and water/sewer charges when he applied for the HOME funds in early 2000. The owner stated that he made an initial payment of \$35,000 from his own funds. When the owner tried to execute the HOME agreement, the City required additional payments of taxes and water/sewer charges. The owner claimed that the Director of Housing stated that the City's Chief Financial Officer would not sign the HOME agreement unless the owner paid the monies owed to the City for the back municipal charges. The owner did not have the funds to make the payment so the City disbursed a partial payment on the HOME award on the condition that the owner simultaneously deposit the HOME check and withdraw \$22,000 to pay the City. The owner also advised that an attorney for the City accompanied the owner to the bank to collect the \$22,000 check after the HOME award deposit.

Neither City Records nor
City Officials Corroborate
Owner's Account

The owner's account of this transaction differs significantly from the City's records. The City's file for the \$33,505 HOME loan included three proposals for work. The file did not contain any documentation that indicated whether the items proposed were actually completed and paid for by the owner prior to the disbursement. On the contrary, the file contained an inspection report dated November 2, 2000 and November 3, 2000, which showed that the inspector was unable to conduct the inspection because the property was unattended at the time of inspection. When questioned about this discrepancy, the Director of Housing stated that he verified the completed work prior to the disbursement. The file did not document the inspection by the Director of Housing.

When questioned about the tax delinquency, the Director of Housing stated that either full repayment of the delinquent amount or a repayment agreement would have been necessary prior to HOME contract execution. Furthermore, the Director stated that the City's attorney would have handled this because it related to the contract signatory process. The City's project files do not disclose any documents relating to the tax issue or the arrangement described by the project owner.

The City's Attorney stated that the Chief Financial Officer was reluctant to sign the contract because of the owner's outstanding debt to the City. Furthermore, he advised that the Office of Housing and the developer handled all negotiations and contracts. Even though this was the Attorney that allegedly accompanied the project owner to the bank to retrieve the \$22,000 tax payment, the Attorney claimed to be unaware of how the city resolved the tax delinquency at 807 Liberty Street.

Ineligible Costs of \$51,385

The City disbursed the remaining \$51,385 of the \$80,495 in HOME funds to the owner without maintaining adequate supporting documentation in accordance with Federal and City policies. The City paid: \$14,205 based on vendor proposals, \$26,800 based on owners' proposals, \$5,180 based on verbal quotes, \$4,700 based on unpaid invoices, and \$500 based on owners' invoices. The City files did not contain any other cost documentation such as contractor/vendor billings, proof of payment, completion statements, or cost breakout.

Unexplained Deviations from Program Policy

The City deviated from its program policy governing disbursement of HOME funds. A memo dated November 19, 2000 from the Program Director to the project owner of 807 Liberty Street described the City's policy as follows:

"These funds are reimbursement funds for work completed. Advances are not permitted. This is why I strongly recommended that you obtain construction/bridge financing to 'front' contractors the funds."

Your project soft costs are only eligible if funds remain after all rehabilitation is completed. Costs such as legal, vacancy/loss rent will be evaluated after all your bids are in.

We identified the following departures from City policy:

1) Disbursements Based on proposals:

As noted above, the City disbursed a total of \$46,185 based on written vendor quotes (\$14,205), written owner quotes (\$26,800), and verbal quotes (\$5,180). The project file did not document the completion and payment for this work.

2) Paying for Soft Costs:

The second disbursement of HOME funds for \$21,609 on December 7, 2000 included \$10,609 in soft costs, even though the file did not document the completion and payment of all hard costs.

3) Usage of funds for other than Gap Financing:

The Program Director explained that the amount of HOME funding is calculated by subtracting the supportable conventional loan from the total development costs. This difference is known as gap financing. Based on our review of the project files and discussions with the project owner, the project at 807 Liberty Street was funded solely with HOME funds. There was no indication that a conventional loan was considered as part of this project. Had the City followed its policy of providing gap financing rather than funding 100% of the project, the City may have been able to reduce or eliminate the HOME funding provided to the project.

The files contained no documentation to justify the departure from City standard policies for the project at 807 Liberty Street.

Program Integrity may be Compromised

Program policies provide assurances that participants of HUD-funded projects are afforded equal and consistent treatment. When adopted policies are disregarded, program integrity may be compromised. In addition, failure to follow standard operating procedures may increase the cost of individual projects and reduce the number of participants that can be serviced.

Auditee Comments

The City's response also addresses the auditors' findings involving two (2) HOME projects at 222 Orange Street and 807 Liberty Street. Many of the auditors' criticisms of the HOME loans appear to result from a misinterpretation and/or misunderstanding of the City's policies and procedures. The City has acknowledged that the 222 Orange Street loan mistakenly assisted an ineligible household, but maintains that the handling of the project's rehabilitation loan was proper. Had the foreclosure not occurred, the City would have pursued repayment of the

HOME funds for that project. It is puzzling why the auditors included the 807 Liberty Street project in the draft report, since the project was cancelled, the money was repaid to the City, and the funds credited on the City's HUD account.

OIG Evaluation of
Auditee Comments

The City acknowledges that it failed to ensure that scarce HOME funds were used for an eligible family at 222 Orange Street, but contends it acted properly on 807 Liberty Street. The City contends that its termination of the project and attempts to secure repayment make the project eligible. Terminated projects are not eligible for funding and repayment of a loan does not make that loan eligible.

Recommendations

We recommend that you:

- 3A. Evaluate all loans made by the City from July 1, 1996 to June 30, 2003 for consistency in the treatment of applicant, compliance with City policies and procedures, and compliance with HUD requirements.
- 3B. Require the City to repay HUD \$46,000 in ineligible HOME costs related to the 222 Orange Street project.
- 3C. Determine if the City appropriately handled the \$81,000 repayment from the project at 807 Liberty Street.
- 3D. Ensure that the City follows Federal requirements and its program policy consistently for all developers to reduce the appearance of any preferential treatment.
- 3E. Require City program officials to adhere to Federal program requirements for disbursements of funds, including the requirement to maintain adequate supporting documentation.
- 3F. Require City officials to implement adequate internal controls to ensure compliance with City and HUD requirements.

Management Controls

In planning and performing our audit, we obtained an understanding of the management controls used by the City that were relevant to our audit objective of evaluating certain loans awarded by the City. We performed a limited review of the City's Department of Community Development management control system as related to the selected loans to determine our auditing procedures and not to provide assurance on management controls. The selected loans are listed in Appendix B.

Management controls consist of a plan of organization, and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports.



Relevant Management Controls

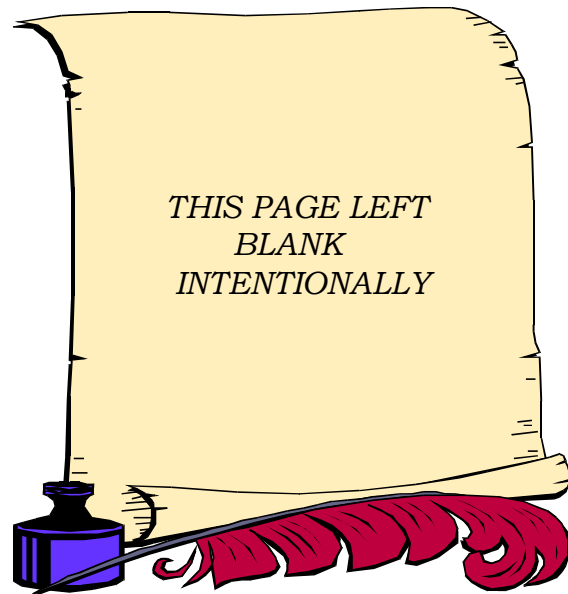
We determined the following management controls were relevant to our audit objectives:

- ◆ Policies and procedures to ensure that funds benefited eligible projects;
- ◆ Guidelines for evaluating assisted projects to ensure that no more than the necessary amount of HUD funds are invested in any one project;
- ◆ Practices used to authorize loans.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Significant Weaknesses

Based on our review, we believe that significant weaknesses exist in the City's adherence to its policies and Federal regulations regarding eligibility of projects, limitation of investment to only the necessary amount, authorization of loans and valuation of loans. The City funded some ineligible projects, provided funding that exceeded the necessary amount, lacked controls over loan valuation and authorizations, and disbursed funds without adequate supporting documentation.



Follow Up On Prior Audits

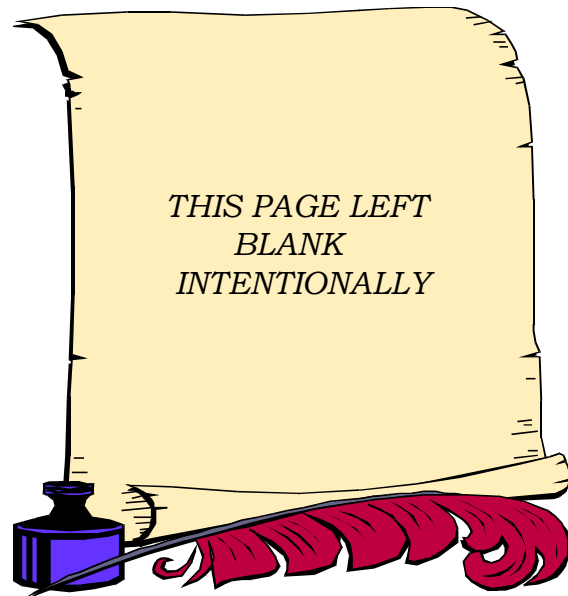
No recent OIG audits have been conducted on the City of Springfield's loan programs. In addition, there are no outstanding OIG recommendations in this area.



Schedule of Ineligible and Unsupported Costs

Recommendation Number	Types of Questioned Costs	
	Ineligible 1/	Unsupported 2/
1A. Ineligible Business Improvement Loans	\$159,794	
1B. Unsupported Business Improvement Loans		\$27,905
2B. Economic Development Loans that do not meet objectives	\$210,000	
2C. Public Service Loans that do not meet objectives	\$150,000	
3B. Ineligible HOME expenditures	\$46,000	
3C. Reclaim repayment	\$80,495	
Total	\$646,289	\$27,905

- 1/ Ineligible costs are those costs that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds. .
- 2/ Unsupported costs are those whose eligibility cannot be clearly determined during the audit since such costs were not supported by adequate documentation.



Loans Reviewed

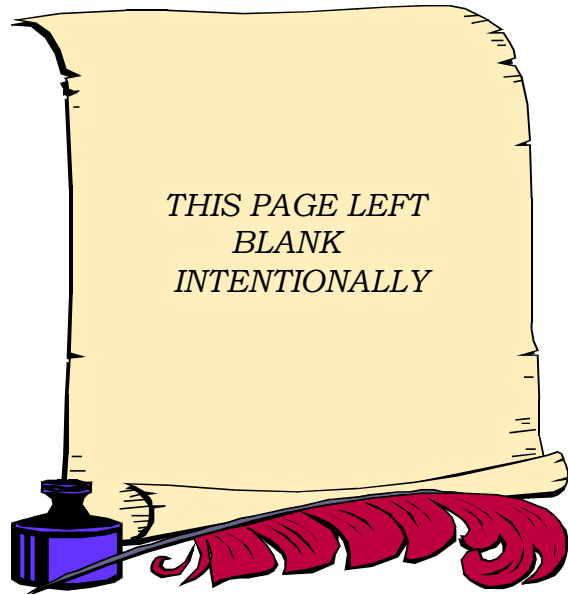
	<i>Project</i>	<i>Type</i>	<i>Award</i>
1	1295 Worcestor Street	Business Improvement Program	\$10,000
2	170 Main Street, Indian Orchard	Business Improvement Program	\$10,000
3	18 Berkshire Avenue	Business Improvement Program	\$10,000
4	247 Hancock Street	Business Improvement Program	\$10,000
5	254 Worthington Street (the 1997 award)	Business Improvement Program	\$10,000
6	340 Main Street (the 1997 award)	Business Improvement Program	\$10,000
7	768 Main Street	Business Improvement Program	\$10,000
8	143 Main Street	Business Improvement Program	\$10,000
9	481-483 Belmont Avenue	Business Improvement Program	\$10,000
10	912 Main Street	Business Improvement Program	\$10,000
11	272 Worthington Street	Business Improvement Program	\$10,000
12	1195 Sumner Avenue	Business Improvement Program	\$5,000
13	272 Bridge Street	Business Improvement Program	\$5,000
14	459 Dickinson Street	Business Improvement Program	\$5,000
15	340 Main Street (the 1999 award)	Business Improvement Program	\$5,000
16	883 Sumner Avenue	Business Improvement Program	\$5,000
17	254 Worthington Street (the 1999 award)	Business Improvement Program	\$5,000
18	487 Main Street	Business Improvement Program	\$4,900
19	166 Eastern Avenue	Business Improvement Program	\$4,503
20	710 Liberty Street	Business Improvement Program	\$4,250
21	1106 State Street	Business Improvement Program	\$7,500
22	232 Worthington Street	Business Improvement Program	\$10,000
23	1383 Main Street	Business Improvement Program	\$10,000
24	84 Maple Street	Business Improvement Program	\$5,000
25	858 State Street	Business Improvement Program	\$4,515
26	398 Dickinson Street	Business Improvement Program	\$4,640
27	1209 Sumner Avenue	Business Improvement Program	\$5,000
28	575 Main Street	Business Improvement Program	\$5,000
29	770 Main Street	Economic Development	\$175,000
30	467 Dickenson Street	Economic Development	\$35,000
31	619 State Street	Public Service	\$150,000
32	222 Orange Street	HOME	\$46,000
33	807 Liberty Street	HOME	\$81,000



Business Improvement Program Projects

Review of 28 Business Improvement Program Loans					
	Project	Award	Ineligible	Unsupported	Eligible
1	1295 Worcestor Street	\$ 10,000	\$ 10,000	Note 1	\$ -
2	170 Main Street, Indian Orchard	\$ 10,000	\$ 10,000	Note 1	\$ -
3	18 Berkshire Avenue	\$ 10,000	\$ 10,000	Note 1	\$ -
4	247 Hancock Street	\$ 10,000	\$ 10,000	Note 1	\$ -
5	254 Worthington Street (1997 award)	\$ 10,000	\$ 10,000	Note 1	\$ -
6	340 Main Street (1997 award)	\$ 10,000	\$ 10,000	Note 1	\$ -
7	768 Main Street	\$ 10,000	\$ 10,000	Note 1	\$ -
8	143 Main Street	\$ 10,000	\$ 10,000	Note 1	\$ -
9	481-483 Belmont Avenue	\$ 10,000	\$ 10,000	Note 1	\$ -
10	912 Main Street	\$ 10,000	\$ 10,000	Note 1	\$ -
11	272 Worthington Street	\$ 10,000	\$ 10,000	\$ -	\$ -
12	1195 Sumner Avenue	\$ 5,000	\$ 5,000	Note 1	\$ -
13	272 Bridge Street	\$ 5,000	\$ 5,000	Note 1	\$ -
14	459 Dickinson Street	\$ 5,000	\$ 5,000	Note 1	\$ -
15	340 Main Street (1999 award)	\$ 5,000	\$ 5,000	\$ -	\$ -
16	883 Sumner Avenue	\$ 5,000	\$ 5,000	\$ -	\$ -
17	254 Worthington Street (1999 award)	\$ 5,000	\$ 4,978	\$ -	\$ 22
18	487 Main Street	\$ 4,900	\$ 4,900	\$ -	\$ -
19	166 Eastern Avenue	\$ 4,503	\$ 4,503	Note 1	\$ -
20	710 Liberty Street	\$ 4,250	\$ 4,250	\$ -	\$ -
21	1106 State Street	\$ 7,500	\$ 3,750	\$ 3,750	
22	232 Worthington Street	\$ 10,000	\$ 2,413	\$ -	\$ 7,587
23	1383 Main Street	\$ 10,000	\$ -	\$ 10,000	\$ -
24	84 Maple Street	\$ 5,000	\$ -	\$ 5,000	\$ -
25	858 State Street	\$ 4,515	\$ -	\$ 4,515	\$ -
26	398 Dickinson Street	\$ 4,640	\$ -	\$ 4,640	\$ -
27	1209 Sumner Avenue	\$ 5,000	\$ -	\$ -	\$ 5,000
28	575 Main Street	\$ 5,000	\$ -	\$ -	\$ 5,000
	Subtotal	\$ 205,308	\$ 159,794	\$ 27,905	\$17,609
	Percentage of Awards	100%	78%	14%	8%

Note 1: These loans are both ineligible and unsupported, but the associated amount is included in the ineligible category only.



Auditee Comments

In its Auditee Comments presented below, the City states that this is the culmination of an investigation. This statement by the City is incorrect.

The issues identified in our report deal with administrative and internal control activities that we feel are necessary to bring to the City's attention now, even though many issues surrounding the City's management actions in these matters, as well as others, remain a continuing interest to our office and other Federal agencies. This report does not absolve or exonerate any individual or entity from civil, criminal or administrative liability or claim resulting from future actions by the Department of Housing and Urban Development and/or other Federal agencies.

The City also believes that the FBI is withholding documents. OIG Staff reviewed many City files before the FBI's seizure of records. We found these files to be incomplete at that time. We do not find the City's belief to be creditable.

CITY OF SPRINGFIELD

LAW DEPARTMENT

Peter P. Fenton, City Solicitor
Harry P. Carroll, Deputy City Solicitor
Chiefs of Litigation
Edward M. Pikula
Corinne A. Rock
Chief Legal Services
Wayman Lee

36 Court Street
Springfield, Massachusetts 01103
413-787-6085
Fax: 413-787-6173

Associate City Solicitors
Kathleen T. Breck
Salvatore Anzalotti, III
Timothy A. Reilly
Assistant City Solicitors
Susan J. McFarlin
Michael E. Mulcahy

September 26, 2003

Mr. Barry L. Savill
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Thomas P. O'Neill, Jr., Federal Building
Room 370
10 Causeway Street
Boston, MA 02222-1092

RE: City of Springfield, MA., Response to Draft Audit Report

Dear Mr. Savill:

Please find enclosed the City of Springfield's Response to the Draft Audit Report, with attached exhibits. We appreciate your consideration in extending the due date for this response.

An electronic copy of the City's Response was also sent to you by email on this date. Please contact me if you have any questions or if you need additional information or documents.

Sincerely,



Kathleen T. Breck
Associate City Solicitor

Rigacvrfnlresp92503.doc



***CITY OF SPRINGFIELD
MASSACHUSETTS***

**RESPONSE TO
FINAL DRAFT AUDIT**

SEPTEMBER 26, 2003

TABLE OF CONTENTS

	PAGE
CITY'S RESPONSE TO EXECUTIVE SUMMARY	2-5
CITY'S RESPONSE TO FINDING #1- BUSINESS IMPROVEMENT PROGRAM	6-13
CITY'S RESPONSE TO FINDING #2 – COMMUNITY DEVELOPMENT LOANS	14-40
770 MAIN STREET	14-20
467 DICKINSON STREET	21-23
619 STATE STREET	24-40
CITY'S RESPONSE TO FINDING #3 – HOME PROGRAM LOANS	41-54
222 ORANGE STREET	43-48
807 LIBERTY STREET	48-54

CITY'S RESPONSE TO EXECUTIVE SUMMARY

The City of Springfield welcomes this opportunity to respond to the draft audit report, a culmination of almost two years of investigation by the HUD Inspector General's Office, in conjunction with the United States Attorney's Office. Over that time, the City has made every reasonable effort to cooperate in providing information to the auditors.

It is extremely important to investigate potential mismanagement or errors in any government office, and the City is always interested in any information which can lead to greater efficiency in the delivery of governmental services. The City is always open to any constructive criticism geared towards improving compliance with all statutes and regulations, as well as the spirit of the law.

In this response, the City has pointed out inaccuracies in the draft report, which should be corrected in order to accurately portray the factual circumstances and legal standards applicable to these projects.

Although the draft report characterizes its review as "limited" in scope, the actual scope of files reviewed was very broad. The City has requested that the auditors disclose the actual scope of all files reviewed in the report narrative as well as in "Appendix B." Similarly, the City has asked the auditors to change the charts to illustrating the annual allocations for the full audit period.

During the audit period, the City's loan portfolio included over 50 Economic Development/ Community Development loans, of which 28 were classified under the "Business Improvement Program" ("BIP"), totaling \$205,677.84. The draft report questions two (2) "HOME" projects with a total value of \$126,495, out of more than 590 HOME projects totaling \$7.3 million the City administered during the audit period. During the same period the City administered over \$40 million in CDBG, HOME, ESG, HOPWA and McKinney funds. The total amount questioned in the Draft Report, \$691,803, represents 1.7% of the dollars allocated.

FINDING #1 – BUSINESS IMPROVEMENT PROGRAM

The \$187,699 in BIP funds questioned by the auditors represents less than one per cent (.6%) of the \$30,969,000 in CDBG funds allocated to the City during the review period from 1996-2001.

It is important to note that the BIP program was part of a comprehensive monitoring conducted by that the Department of Housing and Urban Development (HUD) in Boston in 2000-2001, which identified several “Findings” relative to the program. The City responded to each Finding to HUD’s satisfaction, and the Findings were subsequently closed. In May 2001, HUD determined that the City was “adequately managing its Business Improvement Program (façade) portfolio.”

The City’s response addresses the auditors’ contentions in the draft report, explaining that the City’s own guidelines for the BIP program evolved over time in an effort to improve the program’s efficiency and effectiveness. Divergence from these discretionary policies did not violate any state or federal statutes or regulations

It is also important to mention that the majority of the BIP loans have been repaid to the City. The BIP program was structured as a partial loan and partial grant funding arrangement. The total funds loaned were \$132,749.40; the total amount granted was \$72,918.44. As of September 10, 2003, the City had received a total of \$138,975.32 in repayments (this amount represents principal and interest). The City has also been able to recapture \$6,539.60 in grant funds where the City determined project costs were ineligible. The remaining loan balance is \$33,661.49. The City continues to receive payments and exercise collection activities where feasible.

The City believes that BIP projects reviewed by the auditors were eligible for CDBG funding and met national objectives at the time funding decisions were made. The City has acknowledged that it’s management of the BIP program was at times inconsistent, but as a result of HUD’s monitoring and technical assistance, the City implemented several changes to its management and oversight of the program to avoid these problems in the future. Ultimately, however, the BIP program proved unworkable and it was discontinued by the City.

FINDING #2 - CDBG AND PUBLIC SERVICE LOANS

The City maintains that each of the loans identified in Finding #2 met the applicable eligibility requirements and, where applicable, also satisfied national objectives. For the 770 Main Street loan, the auditors applied the wrong standards for review, since the loan funds were miscellaneous revenue from a repaid UDAG loan, which are not subject to the regulatory requirements cited in the draft report. Regarding 467 Dickinson Street, the funds were used for the acquisition of a blighted, condemned 3-family house, which was then demolished to make way for expanded parking for a neighborhood restaurant, allowing expansion of the business and the creation of additional jobs for low and moderate income persons. The most egregious portion of the draft report, however, is the section criticizing the City's \$150,000 loan to the Daycare Program at a non-profit community action agency ("Agency") at 619 State Street. The auditors decided the Agency did not need the loan money, and that no jobs were saved by the financial assistance, because a projected budget attached to the loan agreement projected a "profit". The auditors also made meritless conflict of interest allegations against two City department heads who stepped in at the request of state officials to help save the non-profit community action agency from being decertified and having its state funding terminated.

FINDING #3 - HOME LOANS

The City's response also addresses the auditors' findings involving two (2) HOME projects at 222 Orange Street and 807 Liberty Street. Many of the auditors' criticisms of the HOME loans appear to result from a misinterpretation and/or misunderstanding of the City's policies and procedures. The City has acknowledged that the 222 Orange Street loan mistakenly assisted an ineligible household, but maintains that the handling of the project's rehabilitation loan was proper. Had the foreclosure not occurred, the City would have pursued repayment of the HOME funds for that project. It is puzzling why the auditors included the 807 Liberty Street project in the draft report, since the project was cancelled, the money was repaid to the City, and the funds credited on the City's HUD account.

CONCLUSION

In sum, the City of Springfield has a strong and demonstrated record of expending Community Development Block Grant monies on a timely basis, consistent with statutory and administrative requirements, and in a cost effective manner. The Directors of the Offices of Community Development, Economic Development, and Housing and Neighborhood Services have over sixty years combined of exemplary, high level management experience in the operation of the CDBG and HOME Programs and are recognized as accomplished professionals.

We firmly believe that the auditors findings contained in the draft report will in time be resolved in favor of the City as appropriate, legitimate and necessary expenditures that most certainly either benefited persons of low or moderate income or served to prevent or eliminate a slum or blighting condition.

Given the built-in flexibility and primacy of local decision making, which stands as a principal cornerstone of the CDBG and HOME Programs, the City's actions with respect to the questioned loans, were, while not perfectly documented, valid and constructive.

FINDING #1**BUSINESS IMPROVEMENT PROGRAM****AUDITORS CONTENTIONS**

The auditors reviewed 28 Business Improvement Program (BIP) projects which received CDBG funding from January, 1996 through April, 2001 totaling \$205,667.84. They determined that 22 of these projects involving \$159,794 included costs that did not comply with key aspects of the City's BIP program "guidelines." They also found a further \$27,905 involved costs that were not adequately supported with national objective documentation or were ineligible for other reasons. The draft report did find \$17,609 used for BIP loans to be eligible and properly documented.

CITY RESPONSE

This response is directed generally to issues raised in the draft report regarding the administration of the BIP as a whole. A complete response to specific statements and/or determinations in the draft report on specific loans and grants under the BIP program is not feasible at this time, as noted below.

BIP Funds Involved Only .67 Percent of One Percent of CDBG Expenditures. In the draft report, the auditors reference the annual allocation of CDBG funds received in Fiscal Years 1998, 1999 and 2000, that total \$15,177,000. In fact, the review period covered six CDBG program years from 1996 through 2001 and the annual allocation of CDBG funds during this actual review period was \$30,969,000. This may put into perspective the \$187,699 in questioned BIP expenditures that have been questioned after an audit that extended for over two years. The amount the auditors found either ineligible or unsupported by adequate documentation represents only .6 of one percent of the funds spent by the City over this 5-year period under the CDBG program.

HUD Field Office Monitoring of BIP Loan Program Found City Management Following Technical Assistance To Be Adequate In 2001. It is also important to note that the City worked closely in its administration of its CDBG program with the HUD Field Office in Boston. That office

conducted a review of the BIP projects during its comprehensive monitoring of the City's CDBG program in 2000-2001. As a result of that review, HUD identified several "Findings" relative to the BIP program. The City responded to each Finding to HUD's satisfaction, and the Findings were "closed" indicating that the HUD Field Office found that the City had resolved satisfactorily the issues involved in the Monitoring Findings. In fact, in May 2001, the HUD program staff stated that it had determined that the City was "adequately managing its Business Improvement Program (façade) portfolio."

The City Instituted Numerous Improvements in BIP Program Management Following HUD Field Office Monitoring Visit in 2000-2001. As a result of the useful suggestions made by the HUD Field Office in its Monitoring in 2000-2001, rather than simply responding only to each Monitoring Finding, reclassifying activities, and providing the requested documentation for various BIP projects, the City also implemented numerous changes to its management and oversight of its CDBG program. For example, the City began conducting eligibility and compliance reviews at the application phase and prior to contract preparation. The City also required national objective documentation prior to contract preparation when possible, and for all projects involving job creation and job retention, the City required a written job agreement.

The City also imposed more stringent requirements than the regulations dictated. For example, the City no longer relied on the presumption of income when determining whether a job benefited a low or moderate-income person. The City began requiring income verification for all jobs regardless of the new employee's address or the location of the business, even though that information is usually sufficient under the HUD regulations. The City also changed its standard contract language to incorporate all policies and procedures and required forms to ensure that sub-recipients were aware of their obligations. The City also began requiring more detailed scopes of services and financial budgets. In addition, the City improved its monitoring procedures to increase efficiency, using standardized checklists, reports and compliance letters. These are a few examples of the various policies and procedures that have been implemented to more efficiently manage the CDBG program.

Approximately 75 Percent of BIP Loans Have Been Repaid. In considering the BIP loan issues raised in the draft report, one needs to note

that almost all the BIP loans have been repaid to the City. Funding for the BIP program was structured as a partial loan and partial grant. For the 28 loans reviewed for the draft report, the total amount provided in grants was \$72,918.44. The total funds loaned were \$132,749.40. As of September 10, 2003, the City had received a total of \$138,975.32 in repayments (this amount represents principal and payment of the modest interest required). The City also recaptured \$6,539.60 in grant funds from recipients where the City determined project costs were ineligible. **The remaining balance on outstanding loans as of September 10, 2003 was only \$33,661.49.** (See attached chart of loans and amounts paid.) The City continues to receive payments and exercise collection activities.

1. Failure to Follow City BIP Policies

The draft report consistently refers to the BIP program “guidelines” as “policies and procedures” when citing “violations”. These guidelines were not established policies and procedures required by statutes or regulations, rather they were simply guidelines developed by the City that were changed over time as experience was gained in order to improve the effectiveness of the program. From its start in 1996, the BIP program administration and guidelines evolved in order to try to make it more effective in stimulating facade improvements and preservation of significant buildings in the City.

It is apparent that the auditors did not fully understand that the City had discretion to modify or waive the guidelines to the benefit of the overall project or program. This was done in the normal course of administration of a program that relies heavily on participation of businesses for who the BIP funding is a relatively modest incentive to make physical improvements. Changes that evolved over time or modifications and waivers to effectuate individual projects were made only for programmatic objectives and were not made to specially benefit any one specific individual business.

Divergence from these discretionary policies did not violate any state or federal statutes or regulations

The auditors applied these evolving City guidelines to identify inconsistencies in program administration. (Report, pp. 6-7). There were four (4) separate “rounds” of funding and applications with the relevant guidelines were not the same for each funding round. Since the guidelines were being modified from one round of funding to the next, it was

inappropriate for the auditors to attempt to apply one set of guidelines to all program participants in all funding rounds.

For example, the draft report disallows costs for “Disbursement without Proof of Payment” stating that the City violated its policies by accepting invoices without proof of payment. Within the BIP application, under the “Guidelines” section, item 7 states “Applicant submits cost documentation (invoices and/or cancelled checks) to the Community Development Department.” The auditors’ claim that the City failed to follow its own guidelines is inaccurate. In fact, the guidelines allowed for submission of invoices and/or cancelled checks. In the instances referenced in the draft report, the City was following the guidelines.

Another example in the draft report cites payment for labor costs as a “violation” of City policies. The draft report states it was the City’s “policy” not to pay for labor costs. To the contrary, the Application Form requests that the recipient submit estimates that contain prevailing wages. This indicates that the City was willing to include labor costs as eligible.

It is true that there were certain basic guidelines that all BIP projects were held to. For instance, applications were required, some form of proof of payment was required, and written contracts were required. This information was usually contained in each BIP file. For the City to respond in a comprehensive project-by-project manner to the allegations in the draft report, the complete BIP files and applications need to be reviewed to determine which guidelines were in effect for each funding round and which guidelines applied to each project. Making that specific determination at this time is infeasible as noted below.

2. Inadequate National Objective Documentation

The draft report identifies 19 projects where national objective documentation is missing or insufficient. The HUD Field Office in Boston identified this problem in its earlier monitoring visit and the City acknowledged that activities had been erroneously classified with some confusion as to what documentation was required to demonstrate compliance with national objective requirements.

As a result of HUD’s monitoring and technical assistance, the City implemented several changes and internal controls to avoid these problems

in the future. In addition, the City has followed HUD recommendations that staff training be provided in the areas of eligibility and national objective determinations. The City hired a consultant who provided basic economic development training to staff focusing on eligible activities, national objective compliance, and regulatory requirements triggered by Special Economic Development activities.

In fact a number of properties receiving BIP grants clearly qualify under Commercial Rehabilitation (24 CFR 570.202(a)(3)) for eligibility, and elimination and/or prevention of slums and blight on an area basis (24 CFR 570.208(b)(1)(i)) for national objective.

The following properties receiving BIP grants clearly meet a national objective: 858 State Street, 912 Main Street, 166-172 Eastern Avenue, 768 Main Street, 247 Hancock Street, 254 Worthington Street, 1383 Main Street and 272 Bridge Street: These eight BIP projects are located in designated “Urban Renewal Areas” and qualify on that basis as meeting a national objective. These areas are in approved Urban Renewal Plans where the goals, objectives and re-use controls for the plans are still in full force and effect.

The addresses and corresponding Urban Renewal Plan Areas are as follows: 912 Main Street and 768 Main Street are located in the South End Plan Area; 247 Hancock Street and 166 Eastern Avenue are located in the Winchester Square Plan Area; 254 Worthington Street, 272 Bridge Street, and 1383 Main Street are located in the Court Square Plan Area; and 858 State Street is located in the Mason Square Plan Area. (A color-coded diagram showing each of the Urban Renewal Areas and the locations of the eight projects is attached as Exhibit A).

Specific Projects Involving National Objectives.

340 Main Street: The draft report disagrees with the determination made by the HUD/Boston Field Office concerning the 1997 award to 340 Main Street. The City provided all documentation required by the regulations and, at HUD’s request, provided a copy of the restaurant’s menu to support the fact that the restaurant is not a pricey, upscale establishment and does serve low- and moderate-income residents. On that basis, the loan was cleared.

143 Main Street and 18 Berkshire Avenue: The draft report claims that these projects did not contain documentation to support that the jobs claimed were for low- and moderate-income persons. This documentation will be obtained from the project owners and submitted to HUD.

254 Worthington Street (1997 award): The draft report states this project contained the job documentation required by HUD regulations but claimed that the business was unable to provide applications or tax forms for the new hires. At the time the project was approved, the City did not require job applications or tax forms as proof that the person was hired. The City relied upon the certifications from the sub-recipient that are part of the income verification form as evidence that the jobs were created. The City has since tightened its procedures and now requires tax forms and job applications.

272 Bridge Street: This project qualifies under Elimination of Slum/Blight in an Urban Renewal Area. As a result, job reporting and documentation requirements are not required.

2. Eligibility

The draft report questions the eligibility of a number of BIP projects. The City maintains that these activities were eligible for CDBG funding at the time a funding decision was made, even if the projects did not specifically accord with BIP guidelines. None of the projects selected for funding were ineligible activities as set forth in 24 CFR 570.207(a). In addition, for the majority of BIP projects, the costs associated with the project were eligible, even if they were necessarily documented in accordance with the City's discretionary BIP guidelines.

In instances where the City determined project costs were ineligible, the City sought and received repayment. The costs incurred under the BIP were allowable costs in accordance with HUD regulations. The auditors simply have questioned the documentation used by the City as to whether it is consistent with City guidelines. As discussed above, it was.

3. Inconsistent Management/Appearance of Favoritism

The draft report contends that the inconsistent management of the program resulted in the "appearance of favoritism." The mention of the word "favoritism" suggests that a select few were singled out for special

treatment, yet the draft report finds the “appearance of favoritism” in 27 of the 28 projects reviewed.

The City acknowledges that the specific requirements applied to individual BIP projects varied, but these occurred in efforts to make the program work in each individual situation. The guidelines were only that and they were changed to improve the program as it evolved over several funding rounds. The City did not necessarily follow its BIP guidelines at all times, but that is inherent in the use of “guidelines” rather than requirements. The City disagrees that this was done to the benefit of a specific individual or groups of individuals. As the auditors found, the files often involved variations from the guidelines of one sort or another, but the City submits that these were appropriate to make projects work in each individual case.

It should be noted that several factors affected management consistency in the BIPs program. First, the BIP guidelines were constantly changing as the effort to increase takeup of BIP grants proceeded. This made it difficult at times for staff and applicants to determine which guidelines were in effect at any given time. Second, the Office of Community Development experienced significant staff turnover that increased the learning time in handling projects. Clearly improvements in management occurred following the HUD Field Office Monitoring in 2001 that clarified a number of eligibility matters.

Impediments to Effectively Responding To Specific BIP Loan Issues. It is no secret that various BIP expenditures have been the subject of an ongoing investigation by other federal agencies, including the U.S. Department of Justice. The City has cooperated fully with the federal investigation.

The City’s ability to respond to the draft audit report on a project-by-project basis has been severely hampered by the fact that the City BIP files have been in the custody of the FBI for over 18 months. In order to prepare this response, since the FBI refused to return the files to the City at this time, the only access to the files was that provided by the FBI to the City’s Chief Litigation Attorney who spent the week following the Audit Exit Conference at the FBI offices in Springfield reviewing files that had been seized 18 months previously from various City offices.

Obtaining the necessary materials from the City’s own files was difficult and expensive. The City believed it needed complete copies of all the BIP files

seized but it was not given the opportunity to make copies, itself, rather the FBI required that the City pay a professional copying firm to have the City's documents copied, at a cost of \$2,718.00. The City did not receive the copies until September 8, 2003. Unfortunately, after staff review of the copies provided by the FBI, it appears that the City has not been provided with all of the documents that should have been in the BIP files when they were seized by the FBI. This has impaired the City's ability to fully respond to the draft report.

Conclusion

The City attempted to offer an incentive program for businesses through the BIP Program. During the operation of the BIP, the City realized that the some of the guidelines that seemed reasonable in theory, did not work in practice. Instead of terminating the program, the City attempted on several occasions to modify or waive guidelines to make the program more effective.

Finally, in 2003, the City determined that the effort was too labor intensive and that not enough was being accomplished by the program to justify its continuation. The City is currently working to complete the remaining open files and once they are closed-out, no additional BIP activities will be funded through the façade program.

FINDING #2
COMMUNITY DEVELOPMENT LOANS

**1) 770 MAIN STREET - \$175,000 LOAN
MISCELLANEOUS REVENUE FROM
UDAG LOAN REPAYMENT**

AUDITOR'S CONTENTIONS:

The auditors' discussion draft audit report contends that a \$175,000 loan funded with CDBG monies, provided as part of a public-private participation loan with a matching private bank loan, where the CDBG funds were used for the acquisition of 770 Main Street and the bank loan for rehabilitation of the property, did not meet the eligibility requirements of Section 105 of Title I of the Housing and Community Development Act of 1974. The auditors also claimed that the City did not exercise prudent lending practices in making its loan. The report also asserts that the assisted activity "displaced" and "eliminated" two existing businesses (hardware store and flooring store) without documenting that the new businesses (gift shop and hair salon) would better serve the needs of a low-income neighborhood. (pp. 21-23).

CITY'S RESPONSE:

BACKGROUND:

In an affidavit provided to auditors at the August 20, 2003 meeting, the City's Economic Development Director ("Director") explained that while serving as the City's Community Development Commissioner (from 1/96 through 4/98), he worked on an Economic Development loan for the property located at 764-770 Main Street in the South End section of the City of Springfield. (Affidavit, Exhibit A, p. 1).

The Director's affidavit states that while working on the response to the draft audit report, he spoke with the loan recipient ("Recipient"), who is now the owner of 764-770 Main Street, as well the attorney who represented the private lender, with respect to the Recipient's acquisition of the premises. (Affidavit, Exhibit A, pp. 1-2).

According to the Recipient, she and her father were approached by the former owners of the property, who owned and operated the hardware store at that location, about the possibility of buying their property at 764-770 Main Street. At the time, the Recipient was renovating a former fire-damaged commercial property located at 744 Main Street. It was common knowledge in the South End neighborhood that the hardware store at 764-770 Main Street was not doing well financially. The former owners suggested that it would be more cost-effective for the Recipient to acquire their property at 764-770 Main Street property, rather than rehab the property a few doors down. The Recipient informed the now former owners that she might be interested in a future acquisition, but was too busy renovating 744 Main Street. Some time later, the Recipient and her father entered into a Right of First Refusal Agreement for the 764-770 property when they learned the property was going on the “market”. (Affidavit, Exhibit A, p. 1).

The Recipient and her father eventually negotiated a deal with one of the former owners and their attorney, to acquire 764-770 Main Street. Their attorney has advised the City that the former owners, who were also longtime family friends of his, were extremely pleased with the transaction. As a result of years of decreased sales, their hardware store had amassed significant debt and the sale price exceeded their expectations. (Affidavit, Exhibit A, p. 1). Upon the completion of the real estate transaction, the former owners closed the hardware store and retired. After the purchase, the Recipient contacted the owners of the building’s other tenant, the flooring store, to discuss entering into a lease arrangement, but the elderly owners of the flooring store indicated that they too wished to retire. (Affidavit, Exhibit A, p. 3).

ELIGIBILITY AND NATIONAL OBJECTIVE:

Miscellaneous Revenue from UDAG Repayment – Must Be Eligible under Title I, No National Objective Required: The City loaned the Recipient the sum of \$175,000 for the acquisition of the property at 770 Main Street as part of a public-private participation loan with a private bank. The Recipient obtained the private bank financing for the rehabilitation costs of \$175,000.

The City loan funds came from *miscellaneous revenues* generated from the repayment of an Urban Development Action Grant (“UDAG”) for the Center Square project, which was closed out in 1984 and fully repaid in 1996. (Closeout documentation is attached as Exhibit D). Under the terms of the 1984 UDAG Closeout Agreement, use of miscellaneous revenue generated from repayment of the original Center Square UDAG loan had to be used for a Title I eligible activity. The loan was not required to meet a national objective. (Closeout Agreement, Exhibit B, section B, p. 3). The UDAG Closeout Agreement states in pertinent part:

“SECTION B: To the extent that Program Income is received by the Recipient *prior to completion* of the UDAG funded Recipient activities, the use of such funds shall be governed by the provisions of the Grant Agreement and 24 CFR Part 570. Any income received *after completion* of UDAG funded Recipient activities shall be deemed miscellaneous revenue, the use of which is not governed by 24 CFR Part 570. Such miscellaneous revenue, however, shall be used by the Recipient only for activities *eligible under Title I* of the Housing and Community Development Act of 1974, as amended, and consistent with the following additional requirements:

The Recipient shall maintain records as to the use of miscellaneous revenue, and shall report annually to HUD (See Annual Post Grant Closeout Report) such funds for a period of 5 years after issuance of the Certificate of Project Completion.”

(Closeout Agreement, Exhibit B, section B, p. 3)(Emphasis added).

The Urban Development Action Grant Closeout Procedures Handbook (Directive Number 6511.12 REV-1) (“Directive”) was published to give HUD Field Office staff and local government practitioners guidance in their monitoring and implementation of UDAG Closeout Agreements. (Copy of Directive attached as Exhibit C). One of the areas where the Directive provides clear guidance is the differentiation between “Program Income” and the more flexible funding known as “Miscellaneous Revenues”. The Directive defines “Miscellaneous Revenues” as UDAG loan repayments and other payments and revenues which are received by the Recipient either, (1) after completion of UDAG-funded Recipient activities for those projects funded before FY 1989 or, (2) after execution of the Closeout Agreement,

for those projects approved during FY 1989. (Directive, Exhibit C, page 2-3).

The Center Square UDAG loan project was closed out in September of 1984 by way of a Closeout Agreement. (Exhibit B). The balance of the UDAG loan was prepaid in full in the spring of 1996. The City's loan commitment for 770 Main Street was made in April 1998, long after the expiration of the 5-year reporting requirements delineated in the Closeout Agreement. (Exhibit B, Section B, p. 3)

The City maintains that the prepaid Center Square UDAG proceeds meet all of the tests for consideration as "Miscellaneous Revenue" set forth in the Closeout Agreement (Exhibit B, Section B, p. 3), and consequently the 770 Main Street loan is not subject to the regulatory requirements set forth at 24 CFR 570, Subpart C as the auditors have asserted.

The Directive requires that projects funded with so-called "Miscellaneous Revenues" qualify as an eligible Title I activity. The Directive provides that "(a)ctivities eligible under Title I of the 1974 Housing and Community Development Act are found at Part 570, Subpart C of the CDBG Regulations **and** Part 570, Subpart G of the Urban Development Action Grant (UDAG) Regulations". (Exhibit C, Section 2-2, par. A, pp. 2-4)(Emphasis added). On pages 2-9 and 2-10, the Directive actually enumerates a number of eligible activities for each of the respective programs. Page 2-9 lists those activities which are eligible under Section 119, the UDAG section of the Housing and Community Development Act of 1974. The second activity listed on the Chart is "land acquisition". (Exhibit C, p. 2-9).

The Closing Documents for the 770 Main Street loan clearly stated that City loan funds were to be used solely for the acquisition of the real estate. Consequently, the City submits that the activity met Title I eligibility requirements found in Section 119 of the Act (24 CFR 570, Subpart G), and the loan was not required to meet the requirements in Section 105 of the Act as the auditors contend.

Displacement of Existing Businesses: The discussion draft contends that the City's assistance for acquisition of this property "resulted in the displacement of two existing businesses" in violation of 24 CFR 570.203(b). (pp. 15, 22). This is not the case. It is the City's position that the special economic development regulations set out in 24 CFR 570.203 do not apply

to this activity. Even were those regulations applicable, they simply require a funding agency, when selecting for-profit businesses to assist, to “minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods.” 24 CFR 570.203(b). That displacement of an existing business occurred does not render the activity ineligible. In this case, the former owners’ attorney explained that the family wanted to sell the property, close their hardware store and retire. As for the other tenants in the building, when the Recipient approached them about continuing their lease for the flooring store, the elderly owners indicated they wanted to close and retire as well. (Affidavit, Exhibit A, p. 3).

PRUDENT LENDING PRACTICES:

Although it is the City’s position that the underwriting requirements of 24 CFR 570 (Subpart C) do not apply to this case, it is important to note that the City did exercise prudent lending practices before making the loan to the Recipient.

In order to undertake the acquisition and rehabilitation at 770 Main Street, the Recipient initially approached a local bank for financing. Officials of the first bank told the Recipient that although they were interested in providing a portion of the financing, they recommended that she contact the City to determine if it had any resources to enter into a “participation loan” with the bank. The Recipient contacted the City’s Community Development Office. She was informed that the City’s interest in such a loan arrangement was contingent on the bank’s participation as the lead lender. The City had entered into these types of loan arrangements in the past, and continued making such participation loans subsequent to this project. In this case, the bank issued a commitment letter (copy attached to Affidavit, Exhibit A) that spelled out the bank’s terms and conditions for making the loan. The City discussed the bank’s commitment with it and also the basis upon which the bank was willing to proceed.

Subsequent to the issuance of the first bank’s commitment letter, the Recipient was able to obtain a commitment with more favorable terms and conditions from a second bank. This financing arrangement also called for the private lender to be the lead lender, a practice that is customary in the public development field in Springfield. The City’s Economic Development Director, in discussions with the second bank’s attorney, made it clear that the City would proceed with the loan based upon the bank’s determination

and performance of the standard commercial underwriting actions required for such a public-private participation loan. After numerous discussions between the bank's vice president, the Economic Development Director, and counsel for the City, the bank agreed to undertake the assembly of necessary information required to exercise its primary underwriting responsibility and the City modified its loan documents to mirror those of the private lender. (Affidavit, Exhibit A, p. 2).

As stated in the Director's affidavit, the City and the private lender agreed that the City loan was contingent upon the project meeting the underwriting requirements imposed by the bank on similar commercial real estate transactions. (Affidavit, Exhibit A, p. 2). It is clear from the review of both the bank's files and the City's files that this was a participation loan. The bank's commitment letter explicitly required the Recipient/Borrower to obtain acquisition financing from the City as a pre-condition for the bank-financed renovation loan. The City was familiar with the bank's underwriting requirements from the many past projects in which the City and the bank participated. The City was confident that the bank's "due diligence" and underwriting procedures were indeed prudent and acceptable and would be adequate to protect the City's interests as well.

Under 570.209, the factors that should be taken into account for underwriting purposes include: (1) the reasonableness of the project costs; (2) that all sources of financing are committed; (3) that to the extent practicable the federal funds are not substituted for non-Federal financial support; (4) that the project financing is feasible; (5) that to the extent practicable the return on the owner's equity investment will not be unreasonably high; and, (6) that to the extent practicable federal and private funds are dispersed on a pro rata basis

The financial analysis of the lenders determined that the project costs were reasonable, including both acquisition and rehabilitation costs. The evaluation of the financial considerations by the bank relevant to this type of commercial loan that was undertaken on behalf of the lenders is described in the attached letter from the bank. (See Exhibit E.) The loans took place and the bank funds were committed as proposed for the project. The bank required the City to provide its funds before the bank would participate in the project. The financing was feasible for the project that was undertaken, it has been successful, and payments are being made on the loans. Lease income was expressly considered in the underwriting as well. The return to

the borrower for the equity investment was determined to be reasonable and consistent with similar commercial loan transactions. In that this was a “matching” loan with similar amounts from public and private sources is clearly consistent with achieving pro rata contributions from each lending source.

Clearly, the underwriting that was undertaken was consistent with the factors applicable were these CDBG funds. While the additional flexibility available when miscellaneous revenue is used for such an economic development loan does not require that these factors be satisfied, although they were reasonably met, in fact.

CONCLUSION:

Findings related to the funding of this project did not adequately take into consideration the more flexible eligibility standards involved. This loan is consistent with the applicable HUD regulations applicable to miscellaneous revenues. The City’s use of UDAG miscellaneous revenues meant that this loan was used for an eligible activity under Section 119 of Title I. Therefore the Section 105 eligibility requirements and business displacement regulations cited by the auditors do not apply. Furthermore, the City exercised prudent lending practices in making the loan, based on the City officials’ discussions with the bank concerning the underwriting undertaken by the private lender acting on behalf of the City as well in this public-private participation loan.

FINDING #2

2) 467 DICKINSON STREET - \$35,000 LOAN

AUDITORS CONTENTIONS

The Draft Report alleges that a loan of \$35,000 from CDBG funds provided for acquisition of 467 Dickinson Street did not meet program requirements and national objectives, and also that no financial underwriting was conducted.

CITY RESPONSE

BACKGROUND. Prior to the City's assistance, 467 Dickinson Street was a vacant 3-family house in substandard condition with code violations dating back to 1994, including, roaches, mice, structural defects, rubbish and garbage. (See Code Enforcement complaint listing, attached as Exhibit A). This house was located in the Forest Park section of Springfield adjacent to a neighborhood restaurant. The restaurant had limited off-street parking available to its patrons and the business owner was interested in expanding the business. The business owner proposed acquiring and demolishing 467 Dickinson Street and expanding the existing parking lot for its restaurant business' operations.

In May 1998, the City provided financial assistance to the business owner in the amount of \$35,000 for the acquisition of the property. This funding was structured as a loan with a forgiveness clause that stated that, if the business occupied the premises for 10 years, \$20,000 would be forgiven. The business was obligated to repay the remaining \$15,000 at \$1,500 per year for 10 years. The City also paid for the demolition of the property totaling \$20,150.00.

The business owner was responsible for all costs associated with the installation of the parking lot (\$18,000) and to pay all outstanding taxes dating back to 1995, with interest and penalties, totaling \$9,753.67. (See Exhibit D). The total assistance by the City was \$40,150. The owner's investment totaled \$42,753.67, basically resulting in a dollar-for-dollar match.

The auditors claim that the project did not meet program requirements. This project is an eligible Special Economic Development activity in accordance with 24 CFR 570.203(b) meeting the national objective of Low and Moderate Income Job Creation (24 CFR 570.208(a)(4)). Acquiring this property allowed the business to expand resulting in the creation of low- and moderate-income jobs. In addition, this activity eliminated a building that was blighted and posed a threat to public health and safety.

This project met CDBG program requirements. In regards to national objective compliance, the business hired two low- and moderate-income persons in March 2000, upon completion of the new parking lot. (See Exhibits B-1, B-2, and C). The parking lot could not be constructed until a zone change was finally approved by the City, which occurred in June, 1999. (See Exhibits E-1 through E-3).

The auditors also claim there was no evidence of prudent lending practices. In determining whether to fund a project, the City evaluates the overall benefit of the project. The guidelines for evaluating and selecting economic development projects is set forth in 24 CFR 570.209. It should be noted that, although some form of underwriting is required for economic development projects, HUD does not prescribe standard guidelines for underwriting. In fact, HUD regulations provide for jurisdictions “to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business”. HUD regulations also allow the jurisdictions discretion on what type of underwriting to elect. Regulations state that: “different levels of review are appropriate to take into account differences in the size and scope of a proposed project, in the case of micro enterprise or other small business to take into account the differences in the capacity and level of sophistication among businesses of differing sizes.”

In evaluating this project, the City considered several factors. First, 467 Dickinson Street was a well-known eyesore and a haven for drug users that was a threat to public health and safety. When the business owner expressed interest in assisting the City in removing this blight, the City made a decision that it would be “appropriate” to provide assistance with CDBG funds. But for the City’s financial assistance, the business would not have made or been able to make the additional investment, a serious blighting influence would not have been removed, and new jobs would not have been obtained for low- and moderate-income employees.

CDBG funding was limited to the actual purchase and demolition of the property. The owner was responsible for installing the parking lot, paying back taxes and providing maintenance of the parking lot, at least over the period of the loan. In support of the project, the business provided a purchase and sale agreement and architectural drawings. Because of the basis for the “appropriate” finding for the use of CDBG funds, financial need was not a factor and detailed financial statements, credit reports, or business plans were not required.

As far as the entity’s economic viability, the restaurant has been in operation since that time and serving the residents of the City and the neighborhood.

The Draft Report suggests that the City had prematurely forgiven the \$20,000 because the annual invoice for payment showed the loan total of \$15,000. The City utilizes an internal tracking system with a spreadsheet showing the principal balance as \$35,000 with \$15,000 loan and \$20,000 forgiven if certain conditions are met. Since the business owner would not be obligated to repay the \$20,000 until the premises was no longer occupied and used as a parking lot, the latter amount would not be included on the yearly invoice. All documentation, including the contract and the promissory note, are very clear that the principal amount of the loan is \$35,000.

CONCLUSION

The business continues to occupy the premises to date and to maintain the property. A CDBG national objective was accomplished. A blighting influence was eliminated from the neighborhood. A well maintained, landscaped parking lot has replaced it. Off-street parking critical to support of the business adjacent to the site acquired has been provided. The restaurant owner has continued to make the required payments.

Finally, as a result, the business has added a banquet facility that would not have been possible without the installation of the parking lot. The business has increased and payroll has increased. In 1998, the restaurant employed 12 people; in 2000 (after the installation of the parking lot), 15 people were employed. With the business expansion, existing employees’ hours have increased.

FINDING #2**3) 619 STATE STREET — \$150,000 PUBLIC SERVICE LOAN
TO NON-PROFIT COMMUNITY ACTION AGENCY
DAYCARE PROGRAM****AUDITORS CONTENTIONS**

The draft Audit Report states that the City “loaned \$175,000 to a non-profit entity located at 619 State Street . . . to provide financial assistance to the [non-profit] for costs associated with the operation of its day-care center.” (Rpt. at p. 24). The actual amount disbursed under the loan by the City was \$150,000, not the full \$175,000. Two disbursements to the non-profit Agency occurred between June 2000 and January 2001. The first disbursement of \$130,000 was made on July 3, 2000, and a second disbursement of \$20,000 was made on November 9, 2000. (Exhibits C-1 and C-2.) Under the loan contract, the time of performance was listed as June, 2000 through June 30, 2001. (*Id.*) The loan principal was repaid in full in August, 2001. (*Id.*) (See Exhibit C attached hereto).

The draft report reveals some confusion about events and facts, and as a result, it currently contains a number of inaccurate contentions and conclusions about the Daycare Program. The auditors questioned whether: (1) the loan met a national objective; (2) the loan was eligible for funding (the Agency’s need for the loan); and, (3) there was a conflict of interest arising out of the loan because of the role played by City officials who had been asked to provide temporary assistance to the troubled Agency under a receivership imposed by the Commonwealth of Massachusetts on the Agency as a condition for continued state funding. These contentions are separately discussed below.

CITY RESPONSE**BACKGROUND**

Before responding specifically to various auditor contentions some background into the circumstances is necessary to fully understand the City’s involvement with this non-profit community action agency.

In May/June, 1999, the Director of the Commonwealth of Massachusetts Department of Housing and Community Development (DHCD), asked the Mayor of Springfield to intervene in the operation of a Springfield-based non-profit community action agency (“Agency”) which was in dire financial trouble and risked the imminent loss of its “community action program” status that would result in loss of over \$2 million in state and federal contracts that fund the Agency’s operations. The Agency’s two largest programs are its Daycare Program (funded with a State Office of Child Care Services contract of up to \$1.2 million depending on enrollment) and a community Weatherization program which received over \$300,000 in federal funding.

The DHCD Director proposed a “Crisis Intervention/Transition Plan” calling for a drastic overhaul of the Agency, including the resignation of the Executive Director and 18-member Board of Directors, and placing the Agency in “receivership” for a period of twelve (12) to eighteen (18) months. (See DHCD Follow-Up Assessment Report, April 7, 2000, Cover Letter, p. 2; Assessment Report, p. 2, p. 3, par. 1; Exhibit A). DHCD’s proposal to the City was very similar to the kind of receivership actions HUD often takes to turn around “troubled” public housing authorities under the TARC program.

The DHCD Director’s plan required the Mayor of Springfield to appoint six (6) City department heads with expertise in the areas of Finance, Procurement, Personnel, Planning, and Human Services to the Agency’s Board of Directors. The remainder of the Board would have to be replaced as well. The DHCD Director also asked that the Mayor bring in a senior City staff person to run the Agency on a day-to-day basis during the temporary receivership period. (See DHCD Report, p. 3, par. 3, Ex. A).

DHCD staff advised City officials that if they did not agree to step in and help, the State would decertify the Agency’s “community action agency” status, pull its Community Service Block Grant funding in excess of \$350,000, and the State Office of Child Care Services would terminate the Agency’s contract of up to \$1.2 million dollars. This would have resulted in the loss of 40-45 jobs, including nearly 30 jobs in the Daycare Program alone, held by mostly low and moderate-income residents, and depriving nearly 80 children from low and moderate-income families of affordable daycare (see Agency’s DHCD Workplan – p. 6 of 35, Exhibit H).

The City agreed to the DHCD Director's request to takeover the Agency effective July 1, 1999. The Mayor appointed six (6) City department heads with the requested expertise to unpaid positions on the Board of Directors: specifically the City's Chief Financial Officer and City Auditor (Finance), the Commissioner of Community Development (Planning), the Commissioner of Health and Human Services (Human Services), the Chief Procurement Officer (Procurement), and a Deputy Personnel Director (Personnel). (DHCD Report, p. 3, par. 4; pp. 5-6, Governance Section; Ex. A).

The City's Chief Financial Officer ("CFO"), in addition to serving as a member of the Board of Directors, was duly elected to serve as the Treasurer of the Board. The DHCD Report indicated that the CFO "as a municipal finance and accounting professional, brings a wealth of understanding and knowledge of the importance of sound financial practices and internal control policies and procedures." (DHCD Report, p. 9, par. 1, Observations section; Ex. A). The CFO received no additional compensation for her service to the Agency as a member of the Board or as the Board's Treasurer.

Mayor Albano also agreed to have the City's Director of Housing serve as the Agency's "Interim Director" ("Interim Director"), responsible for the day-to-day management of the Agency for the temporary period requested by DHCD. (See DHCD Report, p. 3, par. 3, Ex. A). She began serving as the Agency's Interim Director on July 1, 1999, and continued in that role until mid-September, 2000, when the transition period ended. (See DHCD Report, Cover letter, p. 2, Ex. A).

The City and the Agency agreed to pay the Interim Director a stipend of \$288.46 per week (\$15,000 for twelve months), in addition to her regular City salary as Housing Director, to perform these additional duties from July 1, 1999, to June 30, 2000. (See Contract attached as Exhibit B). The contract stated the Agency would reimburse the City for the stipend amount. The Interim Director's modest stipend for taking on the additional responsibilities was approved by DHCD.

DHCD took an active role in monitoring the City's involvement in the Agency. DHCD required the Interim Director, who was responsible for operations of the entire agency, not simply the Daycare Program, to report to DHCD's Assistant Community Service Director on a weekly basis. In addition, an "Oversight Panel" was named to oversee the Agency's progress,

consisting of DHCD Assistant Director, the Mayor of Springfield, and two (2) state representatives. (DHCD Report, p. 3, par. 3, Ex. A).

DHCD and the City agreed that during its day-to-day operation of the Agency, the City would address the Agency's organizational and operational issues identified in DHCD's assessment, build organizational capacity through Board and staff training, and provide financial support to help stabilize the Agency. During the receivership period, the Agency's name was also changed.

DHCD had proposed that the receivership extend for a minimum of 12 months, and a maximum of 18 months. Prior to the City's withdrawal, DHCD was to complete an Agency evaluation and determine whether the Agency could return to independence.

The City's support efforts were successful. DHCD performed an evaluation in April, 2000, and indicated that once the Agency's Board hired a qualified permanent executive director (tentatively projected for June 30, 2000), DHCD was prepared to certify that sufficient progress had been achieved, and practical and proper safeguards were in place to "ensure the integrity and further development of the organization", and that it would be "reasonable to discontinue the state/city oversight and day-to-day crisis/stabilization management currently in place." (DHCD Evaluation Report, April 7, 2000, Cover letter p. 2, last par., Ex. A). The cover letter accompanying the DHCD Report concluded by praising the hard work of the Interim Director and the Agency:

"On behalf of (the) Director . . . , we congratulate interim director . . . and the (Agency) . . . family on their past accomplishments, and commend them for their continued efforts to substantively enhance the quality of life for poor and "at-risk" families and individuals who reside in the City of Springfield." (DHCD Report, Cover Letter, p. 3, Ex. A).

Once the City accomplished its commitment to DHCD to stabilize the Agency and make it self-sufficient, the City department heads withdrew gradually from the Board of Directors, and the Interim Director withdrew from day-to-day operations of the Agency.

AUDITORS CONTENTION

1. The draft report states: “the loan does not meet a national objective.” (Rpt at p. 26)

CITY RESPONSE

This was a loan with CDBG funds to provide a “line of credit” to a non-profit community action agency that was providing daycare services for a limited clientele, a majority of whom were low- and moderate-income families in Springfield. (See DHCD Workplan, Exhibit H, p. 6 of 35). Under CFR 570.208(a)(2) *Limited clientele activities*, CDBG funds meet a national objective and may be used for an activity “(i) which benefits a limited clientele, at least 51 percent of whom are low- or moderate- income persons.” The very nature of the services provided by this “community action agency” and its limited clientele qualify its activities and eligibility for funding under this section.

In fact, under section (iv) this activity is designed to provide employment support services, one of which that is specified is “child care.” There is no question that the majority of persons served by the Agency’s Daycare Program are low and moderate-income families. This loan met a national objective.

AUDITORS CONTENTION

2. The draft report states: “Since the daycare center is profitable, neither jobs nor daycare services would be lost, therefore, the loan does not meet a national objective.” (Rpt. at p. 26.)

CITY RESPONSE

a. The auditors assertion that the Agency was “profitable” and therefore did not need the City loan is simply inaccurate. This misunderstanding of the facts apparently generated the auditors’ incorrect assumptions regarding the loan’s eligibility and whether it met a national objective.

The draft report’s statement that the Agency’s Daycare Program was “profitable” at the time the loan was requested is simply wrong. The

Agency's financial records clearly show the Daycare Program was not profitable when the City took over its operation in July 1999, nor was it profitable during the 12-month period following the loan (July 2000 through June 2001).

The auditors' "profitability" determination was based on a one-page projected "budget" for the forthcoming year for which the loan was requested that was attached to the City loan contract, which, according to auditors, "showed the day care center was self-sufficient earning monthly net income of \$7,713." (Rpt. at p. 24). Thus, the auditors found, "since the daycare center is profitable, neither jobs nor daycare services would be lost, therefore; the loan does not meet a national objective." (p.25).

The fact is that revenues from the Agency's Daycare Program did not exceed expenditures when the City took over the Agency, nor did the revenues exceed costs at the time the City made what was essentially a "bridge loan" to the Agency in the summer of 2000. This loan was in keeping with the State's direction to the City to address the Agency's organizational and operational issues identified in DHCD's assessment, build organizational capacity through Board and staff training, and **provide financial support to help stabilize the Agency.**

The Agency's financial records show that during the first year of the City's crisis stabilization management through its receivership, July 1, 1999 to June 30, 2000, the Daycare Program lost over \$146,000. (Exhibit F). The following fiscal year, July 1, 2000 to June 30, 2001, the Daycare Program had an operating deficit in excess of \$26,000. (Exhibit G). The \$150,000 in loan funds was disbursed to the Agency between July and November 2000. These funds covered expenses that would at best have increased that year's deficit to \$176,000, and at worst, may have resulted in the closure of the Agency as a whole.

The auditors reliance on the profitability issue for their assertion that the loan was not needed completely ignores the State's direction to the City to address the Agency's organizational and operational issues identified in DHCD's assessment and build organizational capacity through Board and staff training. There was a continuing involvement by the State with the management and financial improvements that City staff were able to build into the Agency's operations. This is why the State agency DHCD enlisted

the assistance of the City and imposed a receivership using City staff to impose improvements in management.

Not only was the City to help stabilize the Agency, it was expressly asked to provide financial support as part of doing so. That is why the City loan was essentially a bridge loan that provided a line of credit needed by the Agency until the State could evaluate the changes that had taken place. This consideration appears to have been ignored by the auditors. The projected profitability could not have occurred without the City's management efforts and the availability of its bridge loan. The principal thrust of the state's interest were the management changes without which the state funds would not have continued to flow.

In May 2000, the Agency's Finance Director submitted a letter to Springfield's Community Development Commissioner requesting a loan to assist the Daycare Program. (Agency's 5/12/00 Letter attached as Exhibit D). Attached to the Agency's letter were several documents, including a "Fiscal Year 2000 Daycare Budget" for the period from July 1, 2000 through June 30, 2001. (See Exhibit D, "Budget"). This "budget" projected a monthly surplus of \$7,713 of revenue over expenses, but achieving those monthly amounts was based on a hoped-for increase in enrollment as explained in the "request narrative" supporting the Agency's application:

“. . . By July 31, 2000 we anticipate to be at full enrollment (87-100%) and operating with a positive cash flow.”

(Exhibit D, "Request Narrative", 3rd par.). This projected Daycare Budget became an attachment to the City Loan Agreement (Exhibit E). The HUD auditors relied on the probably unreasonably rosy expectations in this **projected** budget to conclude that the Daycare Program was "profitable".

The Loan Agreement between the City and the Agency (City Auditor's Contract No. 5114) provided the City would "provide financial assistance to the (Agency) for costs associated with the operation of its daycare center." (Contract, Article I, Scope of Services attachment, Exhibit E). The loan was for "up to \$175,000," to be repaid over a 2-year period. (Contract, Article II, Ex. E). **The contract required the Agency to "retain 26 jobs during the term of this agreement at least 51% of which will benefit low to moderate income persons, as defined by HUD. . . ." and ". . . provide needed and necessary day care services to low and moderate income**

families.” (Contract, Article IV, and Scope of Services attachment, Ex. E). The loan funds were provided with the intent that they be used as a line of credit to insure the Agency would be able to make payroll and cover necessary expenses as the City gradually withdrew from its oversight role.

During the 12 months immediately preceding the loan, July 1, 1999 through June 30, 2000 (FY'00), the Agency's financial records show the Daycare Program alone lost \$146,510.00. (Agency's Budget-to Actual Reconciliation, 7/1/99-6/30/00, Exhibit F. This document was given to the auditors at the August 20, 2003 meeting in Springfield.) This time period was the first year of the Interim Director's service at the Agency. (NOTE: Requiring a "budget-to-actual" breakdown was one of several reforms instituted by the City's CFO when she was appointed to the Agency's Board of Directors and began serving as the duly elected Treasurer of the Board).

According to the former Interim Director, the Daycare Program was a significant financial drain on the Agency, which had no other financial means to continue to support such losses. The City loan funds were needed to cover operating losses, pay overdue bills and meet payroll. The former Interim Director recalled that at the time, the City crisis stabilization team was trying to put together a plan to reduce future operating losses, which if not successful risked losing the Agency's Daycare Program altogether.

The \$150,000 City Loan was disbursed to the Agency in two (2) checks: one for \$130,000 dated July 3, 2000; and a second for \$20,000 dated November 9, 2000. (Exhibit C-1). The loan funds enabled the Agency to continue the Daycare Program and work toward reducing future operating losses. During the 12-month period following the first loan payment, from July 1, 2000 through June 30, 2001(FY'01), the Agency's financial records show it reduced its operating deficit to \$26,087.69. (Exhibit G.) (This document was given to the auditors at the August 20, 2003 meeting with the City.) Although substantial, the Daycare Program's FY'01 deficit was a significant improvement from the FY'00 numbers.

Despite the Agency's initial difficult financial situation, however, and because of the efforts of the City who assisted in the Agency's recovery, the Agency was able to repay the City's \$150,000 loan early, in August 2001. (Loan repayment schedule attached as Exhibit C).

b. The auditors also expressed concern that the use of amount drawn down had not been documented. As has been shown, clearly the funds were needed and were used in the operations of the daycare center. There is no showing that the funds were improperly distributed or used.

According to the Interim Director, the City loan funds were needed to meet the operating expenses of the Daycare Program, including paying overdue bills and payroll expenses. Financial records provided by the Agency for the period from July, 2000 to June, 2001, show that the Daycare Program's monthly payroll expenses exceeded \$40,000.00 (See Exhibits M-1 through M-12), and the Program had total annual expenses of \$756,014.92. (Exhibit G).

The Agency's current Finance Director joined SPCA in mid-August, 2000, some five (5) weeks after the first loan payment (\$130,000.00) was disbursed to the Agency. In November, 2000, she wrote to the City asking for a second loan disbursement in the amount of \$20,000. (Exhibit C- 2). The Agency's Finance Director has provided the City with a letter indicating that the \$20,000 in loan funds were to be "used to meet the payroll obligations of the childcare program." (Exhibit K).

While the loan funds once received were deposited in the Agency's accounts and thus, co-mingled with the Agency's operating funds, clearly they were used to pay "payroll obligations" and other expenses of its operation. Since the Agency nevertheless had an annual deficit for that year, clearly these funds were used to cover the some \$756,000 in its actual expenses reflected in Exhibit G.

c. The auditors expressed concern that documentation was not provided for a national objective of low-moderate income job retention, and this required a showing that jobs and services would have been lost without the loan. As noted above, the national objective was satisfied under 570.208(a)(2) that it served a limited clientele a majority of whom were low- and moderate-income.

As discussed earlier, the state DHCD Director in meetings with the Mayor and City officials made it clear that if the City did not step in and help stabilize the Agency, the state was going to decertify the Agency as a Community Action Agency. This would mean the loss of the Agency's

contract with the state Office of Child Care Services (OCCS) valued at up to \$1.2 million dollars, as well as other state contracts.

The loss of the OCCS contract would have resulted in the closure of the Agency's Daycare Program, the loss of over 20 jobs held by predominantly low- and moderate-income persons, as well as the loss of necessary daycare services for approximately 80 children from low- and moderate-income families in the community. (See DHCD Workplan, Exhibit H, p. 6). Given the Daycare Program's huge operating loss in FY'00, the City loan was critical to its very survival, allowing the Agency to retain the Daycare staff jobs and continue to provide necessary childcare services to the low- and moderate-income families it served. If the City had not responded to the State's request for it to take a receiver role, and the state cut-off of funds had occurred, there clearly would have been a loss of jobs and services to the existing low- and moderate-income clientele of the Agency. Given these facts, it is not apparent what additional showing of necessity the auditors would require more than this statement of intentions by the Commonwealth of Massachusetts DHCD to decertify the Agency and cut off its funding from the State to demonstrate that the City action retained jobs.

d. The auditors also expressed concern about the proper handing by the City of the \$150,000 repayment by the Agency: The Director of Administration and Finance for the City's Office of Community Development has reviewed the applicable financial records and determined that the monthly loan payments made by the Agency were booked as "program income" and recorded on IDIS with other program income. Program income funds, as required by HUD, were used for CDBG expenditures prior to any entitlement funds being drawn down.

e. The auditors requested documentation that the Agency reimbursed the City for the Interim Director's \$15,000 stipend: The Director of Administration and Finance for the City's Office of Community Development has provided the following documents showing the Agency reimbursed the City for the Interim Director's stipend: a copy of a December, 1999 invoice from the City's Community Development Commissioner to the Agency requesting payment for the Interim Director's stipend of \$15,000 (Exhibit L-1); and copy of Agency's check for \$15,000 to City of Springfield for "Stipend/Consultant" dated August 15, 2000 (Exhibit L-2); and the "Schedule" form used to deposit the \$15,000 check into the "CD checkbook" (Exhibit L-3).

CONCLUSION

As the Agency's financial records provided to the auditors show, the Daycare Program was never profitable during the City's involvement in the Agency's management, or at the time the City made the \$150,000 loan to assist the program's operation. The document relied on by auditors to conclude the Agency's Daycare Program was "profitable" was simply a **projected** budget for the period from July 1, 2000 through June 30, 2001, as evidenced by the fact that it was submitted with the Agency's loan request in May, 2000. (Ex. D). The "projected budget" assumed increasing enrollment in the Daycare Program to meet the maximum licensed capacity, which did not occur to the extent hoped.

The residents of Springfield benefited from the loan insofar as the continued operation of the Daycare Program retained jobs for low and moderate-income persons, and provided a critical service to its limited clientele of low- and moderate-income families who depended on it for affordable childcare. (Statement of former Interim Director; Agency's DHCD Workplan, p. 6, Ex. H). The Loan was proper, met national objectives, and was repaid by the Agency prior to the repayment deadline despite the Agency's prior difficult financial situation. The auditor's conclusion that the Agency's Daycare Program was "profitable" is inaccurate.

AUDITORS CONTENTION

3. **Conflict of Interest:** The draft report alleges that there was a conflict of interest arising out of the loan because of the role played by two City officials who had been asked to provide temporary assistance to the troubled Agency under a receivership imposed by the Commonwealth of Massachusetts on the Agency as a condition for providing it state funding. Specifically the report asserts: "The two City employees who officiated as the Interim Operations Manager and the Treasurer of the non-profit had a financial interest in the \$150,000 loan the City made to the non-profit." (Rpt. at p. 26).

CITY RESPONSE

The auditors are simply incorrect in their assertion that two City employees had a financial interest or obtained a financial benefit from the City's loan to the Agency. The draft report identifies two (2) City employees by position as having a "conflict of interest" with respect to the \$150,000 loan. They are the City's Director of Housing, who served as the "Interim Director" of the Agency for a temporary period at the request of the Commonwealth of Massachusetts Department of Housing and Community Development, at a stipend (salary) approved by DHCD; and the City's Chief Financial Officer ("CFO"), who served in an unpaid capacity as a member of the Board of Directors and as the duly elected Treasurer of the Board of Directors for a temporary period, and who dedicated untold hours of unpaid service to try to get the Agency's financial affairs in order. As noted above, the Interim Directors' responsibilities of running the Agency were in addition to her duties as Director of Housing for the City.

The \$150,000 City Loan was disbursed to the Agency in two (2) checks: one for \$130,000 dated July 3, 2000; and a second for \$20,000 dated November 9, 2000. (Exhibit C-1). As discussed above, the City loan funds were used by the Agency for operating expenses of the Daycare Program, including payroll expenses, and were not used to compensate the Interim Director, whose stipend was paid directly by the City (Contract, Exhibit B) and later reimbursed to the City by the Agency from other funds. (Exhibits L-1 through L-3). The cost of the Interim Director's stipend was a separately identified obligation that was specifically to be covered by State CSBG funds and the use of CSBG funds to cover her stipend was approved by the State.

The Interim Director: Funds from the City's Loan were not used to compensate the Interim Director, whose 1-year stipend contract had expired (on June 30, 2000) by the time the first loan payment was made to the Agency on July 3, 2000. (Contract attached as Exhibit B; Loan disbursement information, Exhibit C-1). After the expiration of the contract, she stayed on as Interim Director of the Agency for 2 ½ months, until mid-September 2000, without any additional compensation. (Statement of former Interim Director at August 20, 2003 meeting with auditors; Payroll information attached as Exhibit I-1 through I-6). It is important to note that the Director of Housing/Interim Manager had no role in decision-making process for the expenditure of CDBG funds.

The Agency was required to reimburse the City for the Interim Director's weekly stipend for the additional duties of running the entire Agency (not simply the Daycare Program as noted above) on a day-to-day basis. (Contract, Article III C, Ex. B). The Agency was not required to and did not reimburse any part of her base salary as the Director of Housing referred to in Article III(D) of the contract. (Ex. B). The cost of the Interim Director's stipend was a separately identified obligation that was specifically covered by CSBG funds and the use of CSBG funds to cover the cost of the stipend was approved by the State. Thus, State CSBG funds, not City Loan funds, were used to reimburse the City for her stipend. A copy of the Agency's check for \$15,000 reimbursing the City for the stipend is attached as Exhibit L-2.

The Chief Financial Officer: The City's Chief Financial Officer ("CFO") received no compensation for her service as a member of the Agency's Board of Directors, or as the Board's elected Treasurer, during the temporary period of her service.

The discussion draft questions why the CFO signed the City Loan Agreement with the Agency when she was serving on the Agency's Board at the time. (p. 26). As the City explained at the August 20, 2003 meeting with the auditors, the City's CFO is required to review all contracts in excess of one year pursuant to a special act of the Massachusetts Legislature, Chapter 656 of the Acts and Resolves of 1989, Section 2. (Copy attached as Exhibit J). The CFO signs such contracts to designate that she has reviewed them. In this situation, the City Loan Agreement had a 2-year payback schedule, thus requiring the CFO's review and signature. (Exhibit E). The CFO received no financial benefit from and had no financial interest in the City Loan to the Agency and received no compensation from the Agency.

CONCLUSION

The draft report's contention that the Director of Housing/acting as the Interim Director of the Agency, and the City's Chief Financial Officer, "obtained a financial benefit from CDBG assistance" or "had a financial interest in the \$150,000 loan the City made to the non-profit" is simply inaccurate based upon the documentation provided by the City to the auditors. The use of City funds for the loan was reasonable and necessary, and the loan was meet a national objective under

570.208(a)(2) and in addition it served to retain jobs for low- and moderate income employees of the Agency and preserve services for low- and moderate-income families.

As noted above, the auditors seem to have been confused as to the facts and relevant regulations. The allegations in the draft report regarding this City's loan to the Agency should be deleted in their entirety.

**LIST OF EXHIBITS –
FINDING #2 –
619 STATE STREET – DAYCARE PROGRAM LOAN**

<u>Exhibit</u>	<u>Description</u>
A	DHCD Follow-Up Assessment Report and Cover Letter, April 7, 2000
B	City Auditor's Contract No. 4576 – provides for payment of Stipend of \$288.46 per week (\$15,000 annually) for (the employee's) service as Interim Director of Agency, July 1, 1999, through June 30, 2000, in addition to (the employee's) salary as Director of Housing.
C	Community Development log of loan payments made by Agency
C-1	Agency's July 1, 2000 letter requesting draw of \$130,000 loan proceeds; copy of City check for \$130,000 dated July 3, 2000
C-2	Agency's November 2, 2000 letter requesting draw of \$20,000 loan proceeds; copy of City check for \$20,000 dated November 9, 2000
D	Agency's May 12, 2000 Letter to City's Commissioner of Community Development requesting loan, with attachments
E	City Auditor's Contract No. 5114 - City Loan Agreement with Agency
F	Agency's Budget-to-Actual Revenues and Expenses for FY'00 – July 1, 1999 through June 30, 2000
G	Agency's Financial Statement for FY'01 – July 1, 2000 through June 30, 2001

**LIST OF EXHIBITS –
FINDING #2 –
619 STATE STREET – DAYCARE PROGRAM LOAN**

<u>Exhibit</u>	<u>Description</u>
H	Agency's DHCD Workplan/Progress Report for October, 1999 through September, 2000 - See p. 6 of 35.
I	Payroll information for Director of Housing/Interim Director of Agency showing salary as Director of Housing with stipend as Interim Director added (payroll sheet from week ending 6/10/00 – gross pay of \$1755.38 – <u>Exhibit I-1</u>), and her salary as Housing Director without the stipend (payroll sheet from 7/15/00 – gross pay of \$1667.61- <u>Exhibit I-2</u>). Additional payroll records show Director of Housing's salary was increased to \$1667.61 per week (from \$1466.92) as part of a departmental reorganization effective 7/1/00. (Exhibits I-3, I-4.) The Director of Housing's salary was further increased to \$1717.64 per week in October, 2000, retroactive to July 1, 2000, as part of a 3% pay increase for all non-bargaining City employees. (See payroll sheet from 10/28/00 - <u>Exhibit I-5</u>). The final document shows the pay range for the Director of Housing as of July 1, 2000 (including the 3% increase), at Step 4, as \$1717.64. (<u>Exhibit I-6</u>).
J	Chapter 656 of the Acts of 1989 – Special Act of the Massachusetts Legislature, requires City's Chief Financial Officer to review all contracts over one year (Section 2)
K	September 9, 2003 letter from Agency's current Director of Administration and Finance to counsel for City, explaining Agency's use of \$20,000 loan funds disbursed in November, 2000.

**LIST OF EXHIBITS –
FINDING #2 –
619 STATE STREET – DAYCARE PROGRAM LOAN**

<u>Exhibit</u>	<u>Description</u>
L-1	December, 1999 invoice from Community Development Commissioner to Agency requesting payment for the Interim Director's stipend of \$15,000.
L-2	Copy of Agency's check for \$15,000 to City of Springfield for "Stipend/ Consultant" dated August 15, 2000.
L-3	City's "Schedule" form used to deposit the \$15,000 check into the "CD checkbook".
M	Copies of the Agency's monthly expense printouts from July, 2000 through June, 2001.

FINDING #3

HOME LOANS

AUDITORS CONTENTION

The draft report questions the eligibility of expenditures of a \$45,500 rehabilitation loan for one property at 222 Orange Street, and \$80,485 for a second property at 807 Liberty Street, both funded from federal HOME funds. (Rpt. at p. 29)

CITY RESPONSE

The auditors reviewed in excess of 24 HOME projects with combined HOME assistance in excess of \$1,190,000. The report questions two HOME projects. Of these, the loan at 807 Liberty Street was cancelled by the City because the owner failed to adhere to HOME project requirements. At the City's request, the owner repaid all of the \$80,485 that had been advanced and those funds were returned to the City HOME account for other eligible uses.

The City acknowledges that the second property at 222 Orange Street, for which a loan of \$45,500 was provided for the authorized rehabilitation work, was sold to a buyer whose income was 115 percent of median income, applicable to projects funded by Miscellaneous Revenues obtained as a result of repayments from an earlier UDAG. City staff inadvertently applied that standard rather than the 80 percent of median income eligibility standard applicable to HOME funded loans. These were the only HOME funds whose use could be considered ineligible.

To put the auditors comments into perspective, during the audit period of January 1 1996 to March 31, 2001, the City of Springfield awarded \$10,873,000 in federal HOME funds to support four eligible uses; homeownership assistance, existing homeowner rehabilitation, multi-family rental production, and tenant-based rental production. During this same period, the City also utilized in excess of \$1,000,000 in UDAG funds, \$2,800,000 in lead abatement funds and \$1,500,000 in heating system repair and replacement funds, to further the City's housing goals.

The HOME Investment Partnership Program was signed into law in 1990. The Interim regulations were first published in December of 1991 and have been amended three times since enactment. The Final Rule became effective in October of 1996.

The City of Springfield has been an entitlement community/participating jurisdiction since the initial HOME funding awards in 1992. As a participating jurisdiction, the City has committed to appropriately implement housing strategies designed to increase homeownership and affordable housing opportunities for low- and moderate-income persons.

Working with the Community Planning and Development office of the federal Department of Housing and Urban Development, the City has been diligent in pursuing training and guidance on the implementation of this complex housing program. The City has continued to evaluate and revise its internal processes in accordance with the HOME program's Final Rule and HUD-issued policy guidance. Further refinement of policies and practices has occurred as a function of programmatic experience. The systems in place in the early to mid 1990 are not necessarily reflective of the practices today. The City continues to welcome constructive input designed to enhance its HOME utilization and accomplishments.

Much of the report's narrative and the analysis of eligibility are based upon misinterpretations of City policies and procedures. As one example, the report states that it is "city policy to make payment on a reimbursement basis and obtain proof of payment as a condition of disbursement. This is not the City policy. The report cites this "policy" as a reason to disallow cost on 807 Liberty Street. Indicative of the fact this was not City policy is that at least four additional projects reviewed by the auditors, including the 222 Orange St project, used "advances" (i.e. funds released not on a reimbursement basis) to owners so they did not have to pay for the work out of their own funds and then be reimbursed.

A second factor in the auditors' determination of deficiencies appears to be misinterpretation of City staff responses and erroneously applying general comments to specific instances not raised with staff. As a standard practice, both auditors verbally asked numerous general questions throughout the course of any given workday. During the rather extended period of the audit, auditors were given unfettered and immediate access to City Housing

staff. City staff attempted to answer fully each general inquiry, but were not requested to and did not conduct a prior file review. Formal interviews were not conducted.

For example, the Housing Director was asked on numerous occasions questions related to housing development, affordable housing underwriting, tax taking procedures, and the disposition of public property. The City responses were detailed but not project-specific. When appropriate, the City provided the audit team with supplemental documentation to assist in these detailed explanations. Examples of this material include HOME training material developed by the Commonwealth's Department of Housing and Development and a tax title manual created by Citizen's Housing and Planning Association.

The report likewise fails to acknowledge the system enhancements that occurred over the course of the HOME program's evolution. Like all HOME administrators, the City continued to modify its systems in response to HUD policy guidance and operational experience. As an example, currently the City underwriting policy is to maximize private and non-local financial resources and to limit its' local HOME funds to secondary financing. While this is its current method, the City has utilized an array of financing mechanisms in the operation of it HOME program as permitted within the HOME statute.

For instance, prior to 1996 the City had utilized HOME funds for first mortgage financing, interest-rate subsidies, and grants. Additionally, prior to 1997, the City did not underwrite for "gap financing" as defined in the draft report. The City's utilization of HOME funds to further its affordable housing objectives has never been limited to "gap financing" nor is it required to be.

AUDITOR CONTENTIONS ON 222 ORANGE STREET

The Draft Audit Report concluded that use of HOME funds for a \$46,000 loan for the residential property at 222 Orange Street was ineligible and resulted in the owner being unduly enriched. (Rpt. at p. 29)

- A. The loan provided to the owner of a rental property at 222 Orange Street to rehabilitate the property to convert it to a residence for

- affordable homeownership was ineligible because it was sold to a purchaser whose income exceeded HOME affordability limits.
- B. The loan resulted in the owner being unduly enriched.
1. The developer's retention of the full loan amount upon sale was not justified under City gap financing requirements.
 2. The developer was improperly allowed a developer's fee
 3. The existing property debt did not justify the loan amount
 4. The original scope of rehabilitation was not implemented
 5. The City failed to enforce its covenant of affordability

CITY RESPONSE

The project owner applied to the City of Springfield for rental rehabilitation assistance for a two-family house located at 222 Orange Street. The proposed scope of work included lead abatement, plumbing renovations to three bathrooms, heating system replacement, and minor modernization. The application was received, the project reviewed, and the HOME funds committed prior to the tenure of the City's current Housing Director. A copy of the initial rental application is within the City's files.

As the project was located in a neighborhood of low owner-occupancy, and as homeownership is the City's top housing priority (at the time the City was selected as an inaugural partner in HUD's national "Partners in Homeownership" campaign), and as the site was appropriate for affordable homeownership, the City requested that the owner consider undertaking a Project-based Homeownership project, wherein the owner would rehabilitate and sell to an income-eligible household.

Although the project as proposed in the original application was HOME eligible and would have resulted in an enhanced income-producing property for the owner, the owner assented to the City's request. It should be also be noted that the City had available both lead abatement grants and energy assistance grants that could have been made available to this rental property owner.

With the change in the project classification, the City required the submission of a new application. A copy of the Homeownership application is in the City's files. Upon review of that application, the City required the modification of the specifications to delete renovations to the bathroom in a third-floor bathroom. The application was for \$46,615. The City approved

\$46,000. An affordable housing covenant as well as the City's lien (mortgage and security agreement) were recorded on September 4, 1996.

Rehabilitation work commenced in September 1996. The City Rehabilitation Inspector monitored the project and approved nine progress payments. The lead abatement, heating systems, and minor renovations were completed by June 1997. After months of marketing for an eligible purchaser, the property was sold on November 13, 1997. During the marketing period, the City required the property to remain vacant. The owner therefore incurred not only marketing costs but also carrying costs such as insurance, payments of the first mortgage loan, and taxes. These were all HOME-eligible costs, but they were not within the budget and no HOME funds were disbursed for these otherwise eligible costs.

The report cites three deficiencies in the 222 Orange St project. Specifically, 1) that project did not meet HOME Program affordability requirements; 2) that the project received HOME assistance that unduly enriched the owner; and, 3) that the project was not completed in accordance with the scope.

1). The project was intended to meet HOME program affordability requirements. The City recorded an enforceable Affordable Housing Covenant (09/04/96, Bk9610, Pg 512). Unfortunately, the property was sold to an over-income household. A lack of staff understanding on the various funding source restrictions and a lack of coordination among program, administrative, and legal staff resulted in this error.

At the time of the property sale, the City operated a highly successful first-time homebuyer program, which assisted nearly 200 households in fiscal 1996, its first year. The program utilized HOME funds for buyers at 80% or less of median and more flexible Miscellaneous Revenues (realized from UDAG projects) for buyers with incomes between 80-115% of median. To ease the burden on potential buyers, the City created a single application form to be used by all applicants.

The buyers for 222 Orange St completed the required application and submitted all supporting documentation. The staff person performed the appropriate calculations and because of insufficient understanding as to which source of funds had been used for the loan to the developer, certified the household as income-eligible at 115% of median. Unfortunately, the inadvertent mistake was not caught in the review process. The Housing

Director approved the file, which was forwarded to legal counsel to proceed with the closing. All of the source documentation on buyer and City approvals is included within the City's project files. A mistake simply occurred. A review of the file documents clearly indicates that the problem was not in the documentation or the calculations, but rather in what fund source had funded the rehabilitation work.

While this was an unfortunate occurrence, the internal controls had long since been revised so this situation should not again arise. Since the creation of a Deputy Director position in 1997, all project-based homeownership projects are overseen directly by the Deputy. Certification of buyer's eligibility must be reviewed and approved by the Deputy or the Director. In addition, all housing staff including those with administrative responsibility for contracting, invoicing, and IDIS have been trained on the different sources of funds.

Upon notification of the error, the City pursued the enforcement of the Affordable Housing Covenant that had been put on the property. Those efforts were frustrated, however, by the fact a foreclosure occurred and a foreclosure deed was executed on February 26, 2002. The effect of the foreclosure is that the City's recorded Affordable Housing Covenant cannot be enforced.

2) . The auditors also contended that the HOME assistance may have unduly enriched the owner. This audit conclusion is apparently based upon the following: the auditors' assumption that gap financing applied, the improper application of the owner/developer's existing debt, and a misunderstanding as to the justified approval of \$4,225 in developer fees for the owner/developer.

It appears that some miscommunication regarding City underwriting practices between the auditors and City staff may have occurred. The auditors seem to have assumed that the City's current underwriting methodology was in place at the time of the City's commitment to the 222 Orange St project. Yet, the City's project files clearly document that "gap financing" as defined within the audit report was not the method utilized. The auditors claim that the Total Development Cost was \$46,000, but that is not the case. Total Development Costs was not calculated for this project nor is there an analysis of Total Development Cost to After-Rehabilitation Value. The HOME program does not require "gap financing". Indeed,

24CFR Part 92 Section 92.205(b)(1) grants participating jurisdictions the right to establish their own terms of assistance.

The report additionally contains a claim that the City permitted the owner to keep proceeds for cost incurred prior to HOME program. The cost in question is acquisition. This assertion is based upon a misinterpretation of a response from the Housing Director. Yet, when the auditor questioned the current Housing Director regarding the project, she referred the auditors to the project files acknowledging that she had little recollection of the project's specifics as it was initiated prior to her tenure and completed nearly 5 years earlier. In fact, the Housing Director informed the auditor that this was one of the loan commitments that were honored despite a change in City loan administration practices. The auditors reviewed at least six additional projects that had such prior commitments, all of which were honored.

Clearly, acquisition costs were not used to underwrite the project, were not included within the contract, and most importantly were not charged to the HOME program. The application and City contract identify a total project cost of \$46,000.

The budget breaks the project cost into line items of which rehabilitation is \$44,000 (96%) and \$2,000 (4%) in soft costs. Although the project had numerous other eligible costs, the Owner/Developer was not permitted to include these within the contract and therefore was not able to be reimbursed for those real eligible costs.

The audit report contains an analysis of the property's existing debt and concludes that the owner/developer was permitted to retain excess proceeds. This analysis was flawed. If the project was underwritten as "gap financing," the owner's equity contribution is calculated. Equity calculations are complex and would minimally require an analysis of the original purchase price, the amount of the owner's down payment, the pre-rehabilitation value of the property, the capital improvements made through period of ownership, and the principle payment made. The audit report's determination of unduly enriching the owner also inappropriately relies upon the sale of a property that occurred after the sale of 222 Orange St.

The HOME program requires a calculation of the difference between sales price and after-rehab value. The difference is the amount subject to recapture. In this case; the amount subject to recapture is zero.

Another concern raised by the auditors was the City's allowance of a developer fee. Developer fees are allowable costs under the HOME program and are regularly included within a project budget. While the owner/developer in this instance originally did not include a fee within the original budget, shortly after the contract execution, the owner/developer requested approval for such a fee, which was his right. The City assented to this request contingent upon successful completion of the rehabilitation work, which did occur.

3). The audit report also claims that the rehabilitation was not completed in accordance with the original scope. The City's project files indicate that at the City's request the renovation of a third floor bathroom was deleted. This was a consistent City practice to delete requests to fund rehabilitation for plumbing on the third floor so as to decrease the likelihood that a future homeowner might create an illegal three-family property. Rehabilitation work on this project was monitored by a City rehabilitation specialist. Progress payments were approved and released, and all approved work was completed prior to resale.

AUDITOR CONTENTIONS ON 807 LIBERTY STREET

II. The draft report indicates that progress payments from HOME funds totaling \$80,495, 40 percent of the \$210,000 originally approved for the multifamily rental rehabilitation project at 807 Liberty Street, were paid out on this loan. At the same time, the draft report also correctly notes that the project was terminated and the developer paid the City \$81,000 sufficient to fully cover the amount originally advanced. Several additional comments about the project were made essentially based upon perceived deviations from City disbursement policy. These were:

- (1) Contractor invoices were paid rather than requiring reimbursements with proof of payment
- (2) Files did not contain proper source documentation for costs
- (3) Taxes, mortgage payments, and property insurance were paid improperly
- (4) The loan file lacked any supporting documentation
- (5) City "gap financing" requirements were not followed
- (6) The original scope of rehabilitation work was not completed

CITY RESPONSE

Given the fact that the owner/developer for this property fully reimbursed the City for HOME funds that had been advanced before the project was cancelled, it not apparent why the draft report continues to claim that HOME funds were ineligibly spent. The repaid funds were returned to the City's HOME fund account and were spent for eligible projects and activities.

A review of the project history is useful in understanding what occurred and why the City acted to cancel the project and obtain reimbursement of the funds advanced. It also clarifies some of the misunderstanding underlying the audit reports questioning of whether City policies were followed.

The owner of 807 Liberty approached the City's Housing Director to seek support for a proposed low-income housing tax credit application for a two-site multi-family development. During the course of those discussions, the owner was supplied information regarding the City's affordable housing resources. The owner subsequently applied to the City for \$253,000 in HOME resources of which \$213,000 was for rehabilitation.

The 807 Liberty Street application was desirable to the City as it met numerous HOME program goals. It maximized participation from the private sector (92.200), it was located in a neighborhood with no other HOME-funded multi-family properties (i.e. it increase the geographic distribution of assistance) (92.201 (a)(1)), and it was a visible property in need of lead abatement and moderate rehabilitation.

The application stated that the owner was acting as the project's general contractor and would be bidding work by trade. The owner/developer further disclosed that he was seeking to refinance the existing first mortgage.

The City approved \$220,000 in HOME financing, that would hold a second position to the private first mortgage to ParkWest Bank and Trust. The approval was conditioned upon the disclosure of refinancing results and the finalization of bids by trade. An Affordable Housing Covenant as well as the City's lien (mortgage and security agreement) was recorded on August 24, 2000.

Rehabilitation work commenced and was monitored by the City's Rehabilitation Supervisor. Four payment totaling \$80,495.00 (less than 40% of contract amount) were issued for project costs. Payments of \$69,885 (nearly 87%) were issued for rehabilitation work. Costs and payments were tracked by trade line-item and reconciled at each requisition. Invoices and trade reconciliation can be found in the City project file.

In August 2001, the owner informed the City that he did not wish to proceed with the project. The City responded that the project must be completed as proposed, that it could be modified only with City approval, or that the funds would need to be repaid. The owner was provided with a HOME completion report as well as a list of outstanding compliance material. The owner submitted an unacceptable closeout packet and was so informed. Following that, the owner repaid the HOME funds to the City.

The City recognizes that HOME regulations state that a HOME-assisted project that is terminated constitutes an "ineligible activity" and any HOME funds invested must be repaid (92.205(B)(2)(e)). This does not make the expenditure "ineligible." The City terminated the 807 Liberty St. project and completed the administrative requirements related to the termination including securing repayment, in a timely manner. The project was terminated and the funds were returned as reflected on HUD's IDIS system that tracks use of HOME funds. Once the funds were returned, there was no "ineligible expenditure" as alleged in the draft report.

The draft report contends that the funds disbursed were made contrary to Federal program policy and for ineligible costs. It also claims that there were several deviations from City program policy governing disbursements and that the project was not completed according to the original scope of rehabilitation work. These stated deficiencies are the apparent basis for statements in the audit report deeming the costs ineligible. The draft report is incorrect in regard to these contentions.

For instance, the report states that it is City policy to require disbursements on a reimbursement basis and obtain proof of payment as a condition of disbursement. This is not the City policy. The City's practice is to process a developer's invoice after review and approval by an authorized City staff person. Each invoice on this project was reviewed and approved.

Rehabilitation work performed and paid for was reconciled by trade and costs disallowed/ were adjusted when appropriate.

The draft report also contends that the City did not maintain appropriate source documentation. While ideally submitted with the invoice, often this is not the case. Source documentation is required by the City prior to release of the retainage at the time of project close-out. In this instance, this project did not reach that stage as it was cancelled with less than 50% of the HOME funds disbursed.

Within the numerous HOME project files reviewed by the auditors, budget and scope amendments existed as well as disbursements for soft costs. As stated earlier within the City response, at least three projects reviewed contain payment advances. The City policies that the draft report cites simply are not City policies. The City permits payment advances. The draft report's presumption that City policies were violated is unjustified.

The draft report also cites as violations of City policies the payment of current taxes, mortgage payments, and property insurance. All of these costs are eligible under the HOME regulation as part of an operating deficit reserve. The City chose to directly disburse rather than establish an operating account for these items as it afforded greater City control. The HOME regulations permit the creation of an operating deficit reserve by the participating jurisdiction with the remaining unexpended funds to be retained by the project. The City was fully authorized to use the approach it applied.

The draft report's assertion that HOME funds were disbursed for back taxes is erroneous. HOME awards are contingent upon the property owner being in good standing with the City (either current or in an acceptable payment plan). The City did not disburse HOME funds for back taxes in this case, nor does it ever. All project invoices were for eligible cost and approved by an authorized staff person.

The City's first disbursement for eligible costs on this project of \$33,505, which the draft report contends was used for back taxes, includes only eligible costs and was approved by the Deputy Director. The initial requisition includes rehabilitation proposals but the release of funds was contingent on an on-site inspection by the City's Rehabilitation Supervisor to verify the work. The Director of Housing does not perform on-site

inspections to approve requisitions. She did accompany the appropriate staff to guarantee access after the staff was unable to obtain full access as noted within the City's project files. The Rehabilitation Supervisor approved all work. A reconciliation was done of all funds invoiced and released to the work completed. The reconciliation and subsequent tracking of expenditures by trade is documented in the City's file.

The presumed inconsistency in City staffs' verbal accounts regarding the tax delinquency referenced in the draft report can be easily understood. The Developer and the Director of Housing negotiate the terms of the contract. Draft documents are created by the Office of Housing and sent to the developer's counsel. If approved by Developer's Counsel, the contracts are returned to either the Director or the assigned City Attorney. The City Attorney then walks the contracts through the "loop" for sign offs. The Director of Housing informs all developers that when the partially executed contracts are forwarded for City execution, any of the City signatories can stop the process. This disclosure is done so developers are aware that the project cannot commence until fully executed documents are returned to them.

The draft report claims that the City files for this loan are missing any supporting documentation. That contention is in error. An examination of the City's project files would show they contain documentation of on-site inspections and cost breakouts. Additional documentation would have been required to be submitted prior to project closeout, but as this project was terminated and repaid, no close out was conducted or required.

The draft report also makes reference to a partial quotation from a memo, which was not intended as a policy statement, as the basis on which the auditors determined what City policy was for this loan. It was written during the final negotiation regarding the project's budget and must be understood in that context. The owner had questioned the timeframe from requisition to the release of funds. This is a common owner concern to which the City gives the same consistent response: the owner/developer should have access private funds. Disbursements made on proposals are not inconsistent with recommending that an owner obtain construction/bridge financing. Often, owners need to meet contractor payment schedules that are more aggressive than City disbursements.

Approval of additional project soft cost (i.e. modifying the approved budget) was conditioned upon the finalization of all rehabilitation bids, just as stated in the memo. The owner had verbally requested to shift more funding into project soft cost. The cited memo denied that initial request

Although “gap financing” is neither a HUD requirement nor the exclusive City policy for such loans, as noted earlier in this response, this project had a private first mortgage. The City’s project files document the mortgage and contain correspondence to the owner regarding his refinancing attempts. The underwriting for this project included private financing as the project had an existing first mortgage. The file also contains references to the owner’s attempt to refinance and the City’s insistence that the project would be re-evaluated if additional private funds were made available. Had the project been refinanced, the City as a junior lien holder would have had to assent to the terms.

The City agrees with the draft report’s statement that the project was not completed in accordance with the proposed scope. This is for the basic reason that the project was not completed. As less than 40% of the HOME funds were disbursed, prior to the project cancellation, no one should reasonably assume that project completion would be according to the approved scope. As a result of the cancellation, the contract was reduced from \$220,000 to \$81,000 and the previously disbursed funds were collected from the developer.

Projects are underwritten to insure that HOME funds are used to provide safe, quality, affordable housing. HOME regulations encourage participating jurisdictions such as the City to maximize private sector participation and to promote geographic disbursement of projects. The 807 Liberty Street project would have met these HOME program goals if it had been completed.

CONCLUSION

While the City acknowledges that the 222 Orange Street loan mistakenly assisted an ineligible household, the handling of the project’s rehabilitation loan was proper. Had not foreclosure occurred, the City would have pursued repayment of the HOME funds.

In the case of the other loan singled out by the auditors for 807 Liberty Street, the City acted responsibly in fully collecting the earlier disbursed

loan funds, canceling the project when the owner did not want to proceed according to requirements, and returning the HOME funds to the City's HOME account.

Technically, a project that is terminated prior to completion is the equivalent of an ineligible activity. However, the funds disbursed to that point were used in accordance with the original approval of a project that was eligible, and were to that point, an eligible expenditure. The repayment of the funds expended at the insistence of the City makes the issue of "ineligibility" a moot point. Only if the City had not collected the funds spent could the fund use, in reality, be criticized as "ineligible."

The draft report's recitations of various City policies that the draft report presumed to have been violated are simply erroneous. There appears to have been a lacking of understanding on the part of the auditors as to what constituted City policies. The project was properly handled and no HOME funds were improperly spent. All HOME funds are fully accounted for.